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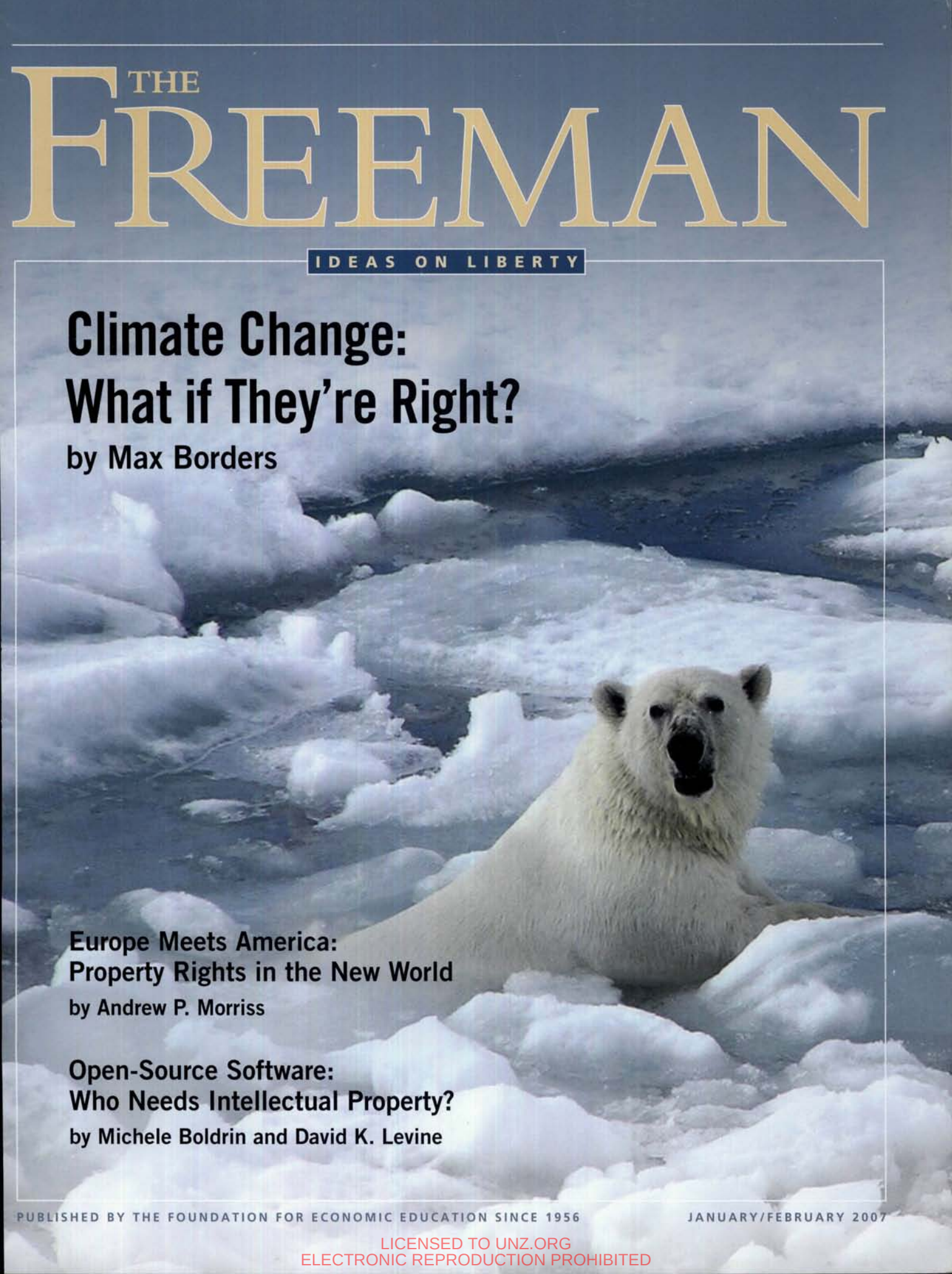

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The Euro versus Currency Competition

BY RICHARD M. EBELING

It is now four years since the euro was introduced as a circulating currency in parts of the European Union. Both Europeans and others are becoming increasingly used to a single money in much of the continent. If the euro remains in use for another five or ten years people may well look back at the multiple European currencies of the twentieth century as some strange archaic arrangement.

Such an attitude would be unfortunate because there are good reasons for considering the imposition of the euro a step backwards from progressive reform and economic liberalization. It is now generally accepted that socialism does not work and that decentralized competitive market decision-making is a far more effective and productive way of arranging economic activities.

In contrast the euro represents an institutional change toward greater monetary central planning. It reduces the ability of ordinary citizens to easily escape from harmful monetary policies by shifting income and wealth into an alternative currency for safekeeping. Yes, there is still the dollar and the yen and the pound. But that does not change the fact that the field of significant competing currencies has been seriously narrowed through the imposition of the euro.

Of course, the euro's advocates emphasize the value of a single money in radically reducing the cost of doing business throughout an increasingly integrated European community. And some EU member nations, wishing once again to compete with the United States in international affairs, view the euro as an important political tool against the dollar.

We need to remind ourselves that central banking is a form of central planning. A central bank possesses monopoly control of the money supply. It determines the quantity of money in circulation and therefore influences the value, or purchasing power, of the monetary unit. It can also influence (at least in the short run) some market rates of interest, which may affect the amount and direction of investment.

Throughout the twentieth century, governments frequently used their central banks to finance budget deficits through money creation—and of course they continue to do so in the 21st century when it serves their purposes. The end-products of such monetary mischief have been prolonged periods of price inflation, which eat away at people's accumulated wealth; distorted market prices resulting in imbalances between savings and investment, and supply and demand; and disincentives for long-term business planning and capital formation.

Why is the euro a less attractive monetary regime than the preceding system of national currencies? About 30 years ago the Austrian economist and Nobel laureate F. A. Hayek delivered a lecture at a conference in Switzerland, later published as *Choice in Currency: A Way to Stop Inflation*. Hayek explained that due to the influence of Keynesian economics over monetary and macroeconomic policy, governments were invariably guided by short-run goals in the service of special-interest groups. The consequence was the constant abuse of the printing press, with its resulting price inflation, to feed the seemingly insatiable demands of those privileged and politically influential groups.

Hayek concluded that some method had to be found to free ordinary citizens from the government's monopoly control of the medium of exchange. The answer, he suggested, is to allow them to use whatever money they choose. Hayek said:

> There could be no more effective check against the abuse of money by the government than if people were free to refuse any money they distrusted and to prefer money in which they had confidence. Nor could there be a stronger inducement to governments to ensure the stability of their money than the knowledge that, so long as they kept the supply below the

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demand for it, that demand would tend to grow. Therefore, let us deprive governments (or their monetary authorities) of all power to protect their money against competition: if they can no longer conceal that their money is becoming bad, they will have to restrict the issue.

Make it merely legal and people will be very quick indeed to refuse to use the national currency once it depreciates noticeably, and they will make their dealings in a currency they trust.

The upshot would probably be that the currencies of those countries trusted to pursue a responsible monetary policy would tend to displace gradually those of a less reliable character. The reputation of financial righteousness would become a jealously guarded asset of all issuers of money, since they would know that even the slightest deviation from the path of honesty would reduce the demand for their product.

Hayek's proposal clearly required the abolition of legal-tender and related laws.

It is true that political authorities and central bankers are no longer dominated by the same type of doctrinaire Keynesianism that pervaded the policy landscape 30 years ago. But governments remain today, as much as then, under the sway of a political ideology that insists it is the duty of the state to regulate the market in the service of powerful special-interest groups, to redistribute wealth, and to secure "safety nets" under most aspects of everyday life. The budgets and deficits of many EU countries demonstrate this beyond any doubt.

The euro's monetary central planners still presume to have the wisdom and ability to target rates of price inflation and move interest rates in directions they consider "optimal." I would suggest that just as the central planners in the Soviet Union were not wise or informed enough to successfully plan the supply of shoes and the production of bread, the managers of the European Central Bank (ECB) cannot know what interest rates should be or what target to set for the general level of prices. Interest rates should be set by the market to bring the actual supply of savings into balance with the demand for loans. And both the general level and the relative structure of prices should be determined by those same market forces, based on people's willingness to trade money for goods and goods for money.

The euro's monetary central planners still presume to have the wisdom and ability to target rates of price inflation and move interest rates in directions they consider "optimal."

No Guaranty Against Inflation

The problem with the euro is that there is no certainty that the current or future decision-makers in the ECB will not come under strong pressure someday from member governments to inflate the currency to prevent fiscal crises, to stimulate aggregate demand to reduce unemployment, or to try to spur "growth" through interest-rate manipulations.

In the "old days" before the euro if one of the national central banks undertook such policies, that country's citizens soon saw the rising inflation rate and related differentials between their nation's currency and the money of the surrounding countries. In the euro zone the impact of similar ECB policies will take longer to fully materialize, and the resulting price effects will be open for comparison with only a few remaining leading currencies.

What then is to be done?

The most desirable goal is the eventual denationalization of money, taking away control from government through the establishment of market-based private competitive free banking. But until that day it would be better if countries that are not yet part of the euro zone stayed out and allowed their citizens the choice in currency Hayek advocated.

If achieving the goal of private free banking seems too far into the future, then citizens of the EU nations should challenge their governments to reverse the euro experiment, restore their national currencies, and allow the people of Europe unrestricted choice in currency. If Hayek's proposal for currency competition were enacted, any additional transaction costs related to trading in multiple currencies might well be lower than those connected with the effects of inflation under European-wide monetary central planning.

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Perspective

Trans-Fattened Government

So people dining out in New York City will be protected from unwittingly—or even wittingly—consuming foods containing trans fats. Trans fats are what you get with partially hydrogenated oils and shortenings, which keep foods like French fries from getting soggy and margarine solid at room temperature.

Trans fats will be banned in the city's restaurants and undoubtedly before long in Chicago and other places because health authorities say they raise cholesterol and cause heart disease.

Ironically, trans fats became popular in food preparation as people were being scared away from the saturated fats in butter and lard. I'm beginning to think the diet authorities, who unfortunately are close to government power, aren't as sure about things as they claim. They told us (on the basis of evidence that has been questioned in many quarters) that saturated fats are bad for our health. So we turned to polyunsaturated and trans fats, only to be told later that they aren't so great either. This sounds familiar. Oh yes. Heroin was developed to help people break their morphine habits. Then methadone had to be invented to break the heroin habit. Now I read that kids are using methadone for kicks. We'd probably prefer they consumed trans fats.

I don't know what, if anything, trans fats will do to you. I am not a physician or a nutritionist. Maybe they are as bad as the most vocal health "experts" say. But I want to point out two things before moving on to the political implications. First, there is some reason for skepticism about the indictment of saturated fat. (For details on the political inspiration for the war on fat, see Gary Taubes's 2002 *New York Times* magazine article "What If It's All Been a Big Fat Lie?") And second, former Cato analyst Radley Balko points out that as consumption of trans fats has increased over the last two decades, heart disease has *decreased* and life-expectancy has *lengthened*. (See his article "Stop Doing What I Said," July 27, 2006, at the Cato Institute website.) What are we to make of that?

Whatever the truth is, this is shouldn't be a political issue. People are perfectly capable of keeping up with the

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latest dizzying news on what's good for you and what's not *without the government banning things.* Earlier generations of Americans would have been appalled by New York City's action. But now many people think nothing of demanding prohibition of anything they dislike. And most of the others accept it.

It's as though the *process* of prohibition meant nothing. But it means a great deal. Let's assume we won't miss trans fats and that healthy substitutes will be easily found and cheap to use. So what? Prohibition is objectionable in itself. If government has the power to ban trans fats in the name of health (an example of what Thomas Szasz calls the Therapeutic State), it will necessarily have the power to prohibit—or, yes, require—other things in the name of health. Power won't be contained, and sooner or later it will wash over something the trans-fat opponents like.

Why is government looking after our health? To keep the price of medical care down, perhaps. But that's only a concern of government because it pays for a lot of medical care (using our money of course). And many people want it (that is, the taxpayers) to pay for it all. When government first intervened in medical matters, we were assured it would not interfere with our lives. Many people believed that story. Now we know better. With the government's medical budgets running wild and its programs facing bankruptcy, control of our decisions has become a matter of fiscal conservatism. The scary thing is that people seem willing to give up freedom to preserve and extend the subsidies. The choice is between government responsibility for medical services or freedom to make decisions. In the long run we can't have both.

We have to drop the idea that if government doesn't protect us from things like trans fats, we are defenseless. Have you read a food label lately? Virtually every product boasts it has no trans fats. Private activities are educating the public (assuming the science is right), and profit-seeking food companies are responding. A margarine, Smart Balance, has been touting its trans-fat-free ingredients for years. Restaurants would do the same. In the meantime, concerned customers can ask questions or avoid situations of uncertainty.

Yes, that means some inconvenience. But it'll be a lot less inconvenient than the impositions of the Therapeutic State.

★ ★ ★

If global warming is manmade and a matter of concern, what should be done about it? Max Borders has an answer to the easier question: What *shouldn't* be done?

It's been over eight years since Julian Simon died. For those who don't know his work—and for those who do—Paul Cleveland and Erin Hagert contribute an appreciation.

The evolution of property rights on the North American continent didn't have to happen. A fortunate confluence of many elements made it possible, as Andrew Morriss explains.

As hard as it is to believe, government-to-government aid is still the establishment's preferred strategy for lifting Africa out of poverty. Joshua Hall and Matthew Hisrich show why this is so wrong-headed.

Most people believe that patents and copyrights are essential to encourage innovation. But this assumption runs up against a modern phenomenon: open-source software. Michele Boldrin and David Levine show how it works.

The Federal Reserve System was supposed to create monetary stability. So why did it bring so much economic turmoil to the twentieth century? Kirby Cundiff has an idea.

A substantial effort has been invested of late in arguing that the presidency is full of heretofore unknown unenumerated, implied, and inherent powers. Joseph Stromberg consults some early strict constructionists on the Unitary Executive Theory.

From our columnists, the following: Richard Ebeling compares the euro to competitive currencies. Donald Boudreaux describes the reach of the Federal Reserve. Stephen Davies reminds us of some overlooked dates in history. David Henderson, who joins our roster of columnists this issue, wonders if government can provide security. And George Leef, reading that we need more college graduates, replies, "It Just Ain't So!"

Books coming under review examine three kinds of fascism, neighborhood power, economic common sense, and Stalin.

—Sheldon Richman
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The More College Graduates the Better? It Just Ain't So!

BY GEORGE C. LEEF

Many people assume the country would be better off with more college graduates.

It seems reasonable if not completely obvious. Nations where few people have much formal education tend to be poor, while nations where a lot of people have college and postgraduate degrees are generally quite wealthy. And within the United States it is indisputably true that on average individuals with college degrees earn considerably more than do those who went no further than high school. There sure *seems* to be a connection between formal education and economic success.

Based on that assumption, the recent, much-publicized national "Report Card" on higher education released by the National Center for Public Policy and Higher Education sounded a loud warning: "The inescapable fact is that the United States is underperforming in higher education." The reason for that declaration is the statistical evidence that some other nations are "educating more people to higher levels."

Especially disturbing to the writers of the "Report Card" is the fact that among young adults 25 to 34, the United States is only tied for seventh in the percentage holding an associate's degree or higher, behind Canada, Japan, South Korea, Finland, Norway, Sweden, and Belgium. (Canada has 53 percent, the U.S. only 39 percent.) The "Report Card" leaps to the conclusion that "What is at risk is America's future educational and economic leadership, if the nation's younger population does not keep pace with the educational attainment levels of earlier generations and with the accelerating pace of higher education around the globe." So we had better "invest" more to get more American students into and through college so they can meet the challenges of the "knowledge economy."

I maintain that this is a case of crying "Wolf!" where there isn't even a Chihuahua in sight.

The problem is that there isn't any necessary connection between an individual's educational credentials and his economic success; nor is there any connection at the national level. You can find individuals who dropped out of high school and make an excellent living in trades like construction work, and you can also find individuals who have college degrees who do lowly work like ushering in theatres. Internationally, you find nations that have "invested" heavily in higher education and seen their numbers of bachelor's, master's, and doctoral degree holders increase sharply but with no noticeable economic gain. Conversely, you can find nations where higher education has never been pushed, but where the standard of living is high. (A good contrast in that regard is between Egypt and Switzerland; the former has been putting lots of resources into education and its low per-capita GDP hasn't budged, while the latter has the lowest college-participation rate of any advanced country but one of the world's highest per-capita GDPs.)

But wait, some will say, the world is entering a "knowledge economy," and surely that will put a premium on having highly educated workers. Furthermore, all good jobs will soon require a college degree—right?

Those pieces of the conventional wisdom are mistaken. Higher-level knowledge is doubtless becoming more important for some people, but the backbone of the U.S. economy will continue to consist of the same kinds of jobs as now. According to the U.S. Bureau of Labor

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Statistics, the growth of demand for workers in jobs that call for no more than a high-school education will be strong. In fact, it is evident that many college grads currently wind up in "high school" jobs because a) there is such a glut of graduates and b) they managed to graduate without acquiring any important skill.

As for the idea that more and more jobs require a college degree, there is a kernel of truth to it. Employers have set a college-degree requirement for applicants for many more jobs than in the past. That, however, is rarely because the work has become so much more demanding that a smart high-school graduate couldn't learn to do it. Instead, employers are using the degree requirement as a screening mechanism. With such a large pool of college graduates available, they can afford to shut out people who ended their formal education at high school. The degree requirement has nothing to do with skill or knowledge (usually, any degree suffices) but is merely a filter against the presumably harder-to-train high-school grads.

Professors James Engell and Anthony Dangerfield hit the nail on the head in their book *Saving Higher Education in the Age of Money* when they wrote, "[T]he United States has become the most rigidly credentialized society in the world. A B.A. is required for jobs that by no stretch of imagination need two years of full-time training, let alone four." Relentlessly promoting higher education doesn't give us a better-skilled workforce; it just gives us credential inflation.

The higher-education establishment would like people to believe that college students eagerly absorb a great amount of knowledge that they employ after graduation to greatly enhance their productivity in the "knowledge economy." Yes, there are some students like that. But many others enter college with poor basic skills and leave without much improvement. The recent National Assessment of Adult Literacy, released about a year ago, found that just 31 percent of college graduates could be regarded as proficient readers. The decline in that number from the assessment done in 1992 is compelling evidence for something that many professors quietly admit, namely, that academic standards have been falling.

Debasing Credentials

They have been falling because many colleges and universities are content to enroll students with weak academic ability and little interest in educational pursuits. Having coasted through their K–12 schooling where, for the most part, teachers are imbued with the "progressive" notion that building students' self-esteem is crucial, those kids reach college expecting the same thing. They expect high grades for minimal work and to get a college degree just for showing up. Because most schools are hungry for revenue, they try to keep such students content by relaxing standards so they won't drop out or transfer. Thus the benefit of higher education for the best students is reduced to allow poor ones to obtain a debased credential.

American prosperity does not depend on educational central planning by the government that attempts to maximize the number of college-degree holders.

Coming back to the alleged need to keep up with the Joneses educationally, if other countries benefit from increased rates of college participation, fine. The United States isn't in a race with them where "leadership" is crucial. We ought to abandon the tribalistic mindset that sees success by others as a threat. More productive firms in, say, Finland or Belgium won't imperil the American standard of living. Maybe the countries that are "leading" us haven't yet reached the point of diminishing returns on higher education, but we certainly have.

American prosperity does not depend on educational central planning by the government that attempts to maximize the number of college-degree holders. Individuals, often aided by their employers, will make the optimal human-capital investments without any subsidization.

What our prosperity does depend on is freedom. The most prosperous nations are that way because the government interferes comparatively little in the economy. Anyone who really cares about enhancing our standard of living should advocate widespread deregulation and the shrinkage of government spending.

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Climate Change: What if They're Right?

BY MAX BORDERS

What do Pat Robertson, Gregg Easterbrook, and Michael Shermer have in common? They've all moved from climate-change skepticism to the "global warming consensus." These leading lights may help guide others toward this consensus too. And given the possibility that believers in global warming are right, I'd like to be charitable and suppose that, first, this consensus is built on the best available science and not just an academic herd mentality, and second, that anthropogenic climate change will yield predictable ill effects.

The itching question becomes: *What do we do?* If your answer is "Get the government to do something," eight world-class economists will give you a failing grade. The economists are Jagdish Bhagwati, Bruno Frey, Justin Yifu Lin, Nancy Stokey, and Nobel laureates Vernon Smith, Douglass North, Robert Fogel, and Thomas Schelling. They comprise the panel assembled by the Copenhagen Consensus Center, headed by Bjørn Lomborg, author of *The Skeptical Environmentalist*. In 2004 the panel, which operates under the auspices of the Copenhagen Business School, inquired into which of the world's major problems would be most soluble (measured by bang for the buck) if $50 billion were available for the task. On a list that included diseases, malnutrition, and economic problems, the group ranked global warming *dead last*. In the language of cost-benefit analysis, government fixes for climate change promise big costs with little to no benefits. (The top-ranked proposal was control of AIDS/HIV. A complete analysis of the rankings is found in *Global Crises, Global Solutions,* edited by Lomborg. The panel will meet again in 2008.)

The Copenhagen Consensus inquired into which of the world's major problems would be most soluble if $50 billion were available for the task. On a list that included diseases, malnutrition, and economic problems, the group ranked global warming dead last.

But you don't need Nobel laureates to explain why government solutions to climate change are wrongheaded. Let's linger on the main solutions offered: cap-and-trade and carbon taxation.

A Kyoto-style cap-and-trade system is one in which a government committee establishes an "acceptable" level of greenhouse-gas emissions for relevant industries. If a plant releases greenhouse gases in excess of the standard, it may go into the "carbon market" and purchase units from other companies that have emitted less than the standards call for and so can sell credits. Thus the process uses quasi-market mechanisms to cut emissions—purportedly minimizing costs to the plants.

Capping might work well to clean up, say, the Chesapeake Bay. But if applied globally the problems are manifold. First, no cap-and-trade system yet conceived

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has been able to promise a significant reversal in warming trends. (Even a number of Kyoto signatories have admitted this fact.) To bring about an abatement of warming (based on current climate science), cap-and-trade standards would have to be set so high that many industries would be crippled, with unforeseeable ripple effects, potentially leaving millions without work in the developed world. If there are fewer economic resources as a result of the standards, it will be harder to adapt to local global-warming problems.

Second, a truly effective cap-and-trade system would require virtually unanimous agreement from the developing world as well. If developing countries were to opt out, their industries would produce more while industries in the developed world produced less. So emission-levels would remain unchanged at best. On the other hand, even if the emerging giants—for example, China, India, Russia—were somehow convinced to agree to a cap-and-trade scheme, their development would be severely retarded, leaving millions destitute.

Third, unanimous international agreement, even if it wouldn't sound the death knell for the developed economies, would kill the hopes of the poorest nations.

But unanimity is not feasible, given the incentives to defect. And temptations to do so by high-growth industrial newcomers like China would be especially great. Cap-and-trade would thus provide an indirect subsidy to the developing world—with all its dirty, less-sophisticated carbon-emitting industries. Emitters would subsequently be encouraged to move to defectors' shores—often to countries with poor political institutions—despite the risks. This outcome would mean little for economic growth in the developed world, force industrial collusion with corrupt governments in the developing world, and do nothing for climate-change abatement. (Indirect subsidies to poor countries may sound great to someone who cares about global redistribution; but it does not bode well for those keen to stop global warming.)

In short, an international cap-and-trade system would seem to offer an unpleasant choice of evils. Ad hoc attempts to lessen such evils after the fact would result in unintended consequences and epicyclical policies.

Carbon Taxes

What about carbon taxes? Overall, similar cost-benefit disparities affecting cap-and-trade apply also to taxes. But at least to some with a market orientation, taxes would have the effect of directly taxing a "bad" (greenhouse-gas emissions) rather than unpredictably taxing a "good" (such as revenues). Thus companies would pay to pollute, and the economic effects would be easier to predict and measure.

The U.S. government largely agrees, and in comparing the two schemes, it comes down largely on the side of taxes. According to the Congressional Budget Office's issue brief "Limiting Carbon Emissions: Price Versus Caps" (March 15, 2005):

> The cost of meeting a given cap on carbon emissions is likely to be difficult to estimate for at least three reasons. First, the cost of meeting a future cap would vary significantly with the amount of growth in carbon emissions in the interim. Those emissions are difficult to predict: they are a function of numerous factors, including population trends, economic growth, and energy prices. Second, policymakers have less information about the cost of controlling emissions than do the firms that create them. Third, the cost of meeting the future cap will depend on the technologies that are developed to reduce carbon dioxide emissions and the economic consequences of adopting those technologies—neither of which can be predicted with certainty.

But in terms of abatement, it's not clear that taxes could reduce emissions as effectively as caps. In fact, most economists believe that a cap-and-trade system would have a more predictable (and forceful) effect on abatement—notwithstanding its effects on the economy.

> If we keep getting richer, we may find technological measures both for mitigating negative effects of climate change as well as for sequestering greenhouse gases.

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So, sort of like with Heisenberg's Principle, it's all in where you want your uncertainty.

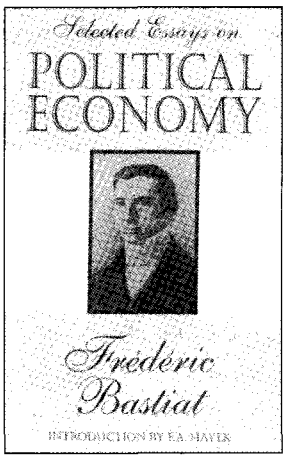
Opting for Taxes

It is predictable that the government would opt for taxes: it likes the revenue. Similarly, "bootlegger and Baptist" coalitions—alliances of privilege-seeking firms and moralistic environmental activists—would benefit more from taxation than capping. Clever companies like Duke Power and Progress Energy have already begun to side with environmental groups to lobby government for carbon taxes instead of caps. Why? So they can benefit from their competitors' taxation woes. (Progress and Duke have nuclear and natural-gas interests.) Alas, rent-seeking companies would turn right around and burn their natural gas for energy, only to leak methane, which has a 25-times greater greenhouse effect than carbon dioxide. Of course, methane and H_2O emitters could be taxed too, but then you're back to the overall problem of how much of the global economy you have to cripple before the globe cools down.

In any case, the Copenhagen Consensus panel and a number of other economic realists think the best thing we can do for climate change is to make local adjustments. (See "Living with Global Warming" by Indur Goklany, www.ncpa.org/pub/st/st278/.)

If we keep getting richer, we may find technological measures both for mitigating negative effects of climate change as well as for sequestering greenhouse gases. Until then, very few credible economists argue that we should slow growth or hobble the global economy—assuming, that is, the climate change skeptics are wrong. What we are left with, then, is an ironic symmetry between two sets of consensus: one that says man is warming the earth and one that says we'll do best simply to adapt.

Selected Essays on Political Economy



By Frédéric Bastiat

Introduction by F. A. Hayek

Frédéric Bastiat (1801–1850) was the most uncompromising advocate of laissez faire in the nineteenth century—and arguably the most quotable! Here, in a single volume, are Bastiat's most brilliant contributions to the controversies of his age.

Although written over 150 years ago, these masterpieces of eloquent argumentation are still relevant to the issues of our own day: communism, labor unionism, protectionism, government subsidies for the arts, colonialism, the welfare state, the right to employment, and the unseen consequences of government interference with free exchange.

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Remembering Julian Simon

BY PAUL A. CLEVELAND AND ERIN HAGERT

The late Julian Simon was not a household name, but he left an indelible mark nonetheless by demanding that environmentalists produce evidence for their doomsday predictions. Meanwhile, he produced his own evidence showing that the planet was becoming more, not less, hospitable to human life.

Born in 1932, Simon grew up in a Jewish family in New Jersey and absorbed many of the popular environmental and economic misconceptions of his day. However, in time questions arose that eventually led him to reject those misconceptions and launch an offensive on behalf of sound thinking and human creativity.

Julian Simon (1932–1998)

People, Simon realized, are not mere consumption machines. As his colleague Stephen Moore noted in a eulogy for Simon, who died in 1998, it made no sense to him that when a calf is born in a country, per-capita GDP rises, but when a human being is born, per-capita GDP falls. The ability of people to create wealth gives rise to economic progress and promotes general well-being. From this realization Simon went on to dispel the myths of overpopulation and resource depletion.

Simon's adversaries derive their ideas from various faulty environmentalist assumptions traceable back to Thomas Robert Malthus. In the late eighteenth century Malthus put forth his famous but bleak principle that population growth would outpace food production. In modern times this kind of thinking has led to government intervention of various sorts, including the barbaric one-child policy in China.

But Malthus was wrong (as he conceded in later editions of his book). He assumed people would not innovate or change their behavior in connection with changes in their economic situations. As Simon noted, technological and economic advances permitted not only the maintenance of a larger population but also a significant increase in living standards. The rise in per-capita food production has exceeded population growth.

Though this truth is well established, it has not been well received in the academic world or generally. Environmentalists such as Paul Ehrlich persist in promoting Malthusian ideas, claiming that people are destroying the environment and that if anything is to be left for our children, the world must be protected from capitalism. In his 1968 book, *The Population Bomb*, Ehrlich wrote, "In the 1970s and 1980s hundreds of millions of people will starve to death. . . . At this late date nothing can prevent a substantial increase in the world death rate."

It never happened. Yet such nightmare scenarios are still promoted by the media, the public schools, and opportunistic politicians. The stories have been told so often that most people take for granted that we are running out of food and natural resources and that government needs to do something now.

But as Simon pointed out, "Every agricultural economist knows that the world's population has been eating

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ever better since World War II. Every resource economist knows that all natural resources have been getting more available rather than more scarce, as shown by their falling prices over the decades and centuries." The price of food relative to wages in the United States is now only about a tenth of what it was in the 1800s.

Simon was a pioneer in proving the doomsayers wrong. In many books and articles he used hard data to wage an assault on a vast number of environmental myths. In his best-known book, *The Ultimate Resource*, he went to the heart of the issue: human intelligence is the most valuable resource because it discovers uses for nature's materials. In other words, people *create* resources out of otherwise useless stuff. Moreover, he observed that the advance of human well-being has come in conjunction with free markets, which allow the greatest latitude for human ingenuity. As a result, life expectancy has increased, which in turn has led to the population boom.

In his best-known book, *The Ultimate Resource*, he went to the heart of the issue: human intelligence is the most valuable resource because it discovers uses for nature's materials.

This conquest over premature death is something to celebrate not lament. Human beings live longer, healthier, and more comfortable lives than ever before. In a 1994 study Simon concluded that "everything we buy—pens, shirts, tires—has been getting cheaper over the years because we know how to make them cheaper."

What is even more astonishing is that "natural resources have been getting cheaper even faster than consumer goods." This is exactly opposite of what the environmentalists predict. Simon's key realization is that people, when left to their own devices, will forever improve their knowledge of how to make products cheaper and will constantly come up with better alternatives. For example, before its utility was discovered, crude oil was considered a nuisance that devalued property. Only when someone found that kerosene, an efficient illuminant, could be distilled from it did oil become valuable. "Minds matter economically as much as or more than hands or mouths," Simon said. "Human beings create more than they use, on average. It had to be so, or we would be an extinct species." He showed that "almost every economic and social change or trend points in a positive direction, as long as we view the matter over a reasonably long period of time."

The Bet

Simon was provoked to put his money where his research was when he heard Ehrlich say on "The Tonight Show" in 1980, "If I were a gambler I would take even money that England will not exist in the year 2000." Simon bet that any five resources of Ehrlich's choosing worth $1,000 would be less expensive in real terms in a decade. The loser of the bet would pay the difference in price to the winner. In 1990 Ehrlich's choice of copper, chrome, nickel, tin, and tungsten was not only cheaper after adjusted for inflation but also in nominal terms. On average the prices decreased 40 percent. As Simon had predicted, the metals became cheaper because human innovation created less-expensive ways of mining them as well as substitutes for them. Ehrlich paid Simon the $576.07 difference but said he had not changed his mind about the future. Which one was the scientist?

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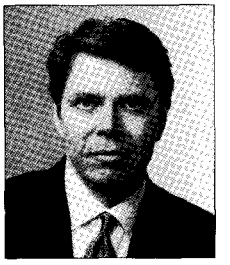

The Fed's Potent Power

BY DONALD J. BOUDREAUX

The Federal Reserve holds the fate of the U.S. economy in its hands. Or that's the conclusion many observers draw when they watch investors react wildly to the most minute details of the Fed's policy statements.

This conclusion is at once exaggerated and accurate.

It's exaggerated because, at bottom, the Fed controls only the supply of dollars. All the entrepreneurial creativity, the risk-taking, and the human effort that generate our prosperity are in the hands of each of us. If we consume without saving and laze about, or if other government agencies tax and regulate us imprudently, the economy will decline, regardless of how wisely the Fed behaves.

But the Fed's control of the money supply nevertheless is an extraordinarily potent power. By manipulating the money supply the Fed can distort one of the economy's most vital prices: interest rates. These rates coordinate economic activity over time.

The Fed's control of the money supply nevertheless is an extraordinarily potent power. By manipulating the money supply the Fed can distort one of the economy's most vital prices: interest rates.

Suppose we choose to save more. This change in our preferences would mean that we are willing to consume fewer things today in exchange for more things tomorrow. From each of our perspectives, this savings involves actions such as putting more money into savings accounts or buying more shares of corporate stock. From the economy's perspective, however, additional savings releases some resources from the need to produce goods for consumption today. These resources become available for use in producing more capital goods and services—more factories, machines, and R&D.

Regardless of perspective, an increase in savings reduces real interest rates. These lower rates help to "tell" investors to produce fewer consumption goods and more capital goods. Of course, each investor sees only the lower cost of borrowing. But this lower cost means that some investments that previously were unprofitable are now profitable. Profit-seeking investors rush resources into these now-worthwhile projects.

Now we can see the potential problem with the Fed's control of the money supply. Because savings, lending, and borrowing are done in dollars, when the Fed pumps out too many dollars it appears to banks as if saving has risen. Banks have more funds on hand to lend. Competing for business, banks then naturally lower interest rates, prompting investors to borrow more in order to produce more capital goods and services.

But increasing the money supply does not really increase people's willingness to save. The lower interest rates caused by money-supply growth are an economic lie. They trick investors into thinking that income earners have become more willing to supply resources over time to support investment projects. The genuine interest rate—the one matching people's willingness to save with investors' willingness to invest—has not fallen.

After the Fed's initial wave of new money works its way through the economy—sparking, by the way, some price inflation—banks find that people in fact are still saving at the same lower rate as before the Fed injected the new money. Banks will thus raise interest rates back to previous levels that accurately reflect people's willingness to save.

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The Fed's economic lie, though, has genuinely sour consequences. If an investor builds a new factory, he expects to be able to acquire the materials and labor he'll need over the course of decades to operate the factory profitably. Trouble is, because he was lured to build this factory only by artificially low interest rates, once rates are restored to their truthful, higher levels, the factory owner will find that he can't operate profitably with the additional cost of borrowing. (Remember, the factory was thought to be profitable only because the Fed lowered interest rates artificially.) As soon as the owner realizes this fact, he cuts his losses by liquidating part or all of his interest in this project. Workers lose jobs.

The Fed—although thankfully not under the direct control of Congress or the president—is a government institution influenced by political considerations. If such job losses are widespread, the Fed might succumb to pressure to "solve" the problem by injecting even more money into the economy and thus keeping interest rates artificially low for a longer time. This tactical lie might mislead investors for a while longer (perhaps until after the next election). But the Fed can't lie forever. Investors eventually catch on that the amount of resources that income earners want to devote to investment is less than the amount required to sustain current levels of investment. At this point, continued injections of money by the Fed lead only to inflation without sparking an even temporary economic boom. Recall the 1970s stagflation.

Milton Friedman's famous solution to this problem was to oblige the Fed to follow a "monetary rule"—that is, to increase the money supply by no more than the annual growth rate of the economy.

Compared to a Fed intent on using monetary policy to manipulate economic activity, Friedman's monetary rule would be an improvement. But a far greater improvement would be to get government out of the money-supply business. Let private banks issue money in competition with one another.

It Can Work

When people today hear this proposal their first reaction is disbelief. "That can't work!" they say. But this assertion is belied by history. As Lawrence White, George Selgin, Kurt Schuler, and some other scholars have shown, "free banking"—which is what competitive note issue is called—has been tried several times throughout history, typically with much success. (Larry White's 1984 Cambridge University Press book *Free Banking in Britain* and George Selgin's 1985 Cato Institute essay "The Case for Free Banking" remain among the best introductions to this important topic.)

A far greater improvement would be to get government out of the money-supply business. Let private banks issue money in competition with one another.

Banks' desire to win customers keeps them from over-issuing their notes. No one wants to hold, or to accept in payment, currencies whose value is less secure than other available currencies. This same desire propels banks to find ways to reduce their customers' costs of deciphering prices expressed in different currencies.

This competition, along with ridding money-supply decisions of political influences, is the best way to ensure that prices—including interest rates—reveal as accurately as possible people's demands, supplies, and preferences for future consumption over current consumption. Economic decisions will be even better with money supplied competitively rather than politically.

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Europe Meets America: Property Rights in the New World

BY ANDREW P. MORRISS

When Europeans arrived in the Americas and began to claim the rich lands they encountered, they brought with them an equally rich European tradition of property law and justifications for establishing property rights. Today these are often mistakenly lumped together into the law of conquest, sometimes in an attempt to cast modern titles into doubt by rooting them in violence. However, the ideas about property that the Spanish, Portuguese, French, Dutch, and especially English colonists brought to the Americas were far more complex than "might makes right." Many of those ideas became established in American soil and some were transformed by their encounter with the New World. In some of the new nations of the Americas, the result has been a long tradition of respect for property rights. In others, an opposing tradition of contempt for property rights took root.

One of the most enduring myths of the pre-European Americas is that the cultures were a kind of property-less Eden, in which various peoples existed in harmony with one another and with nature. Even a brief survey of the major pre-Columbian civilizations of the Inca, Aztec, Maya, and North American tribes quickly demonstrates that such a view neglects well-established customs that included recognizable forms of property in scarce resources, from weapons to hunting territories, as well as conflicts among tribes and other groups over control of territories.

One of the most enduring myths of the pre-European Americas is that the cultures were a kind of property-less Eden, in which various peoples existed in harmony with one another and with nature.

Native Americans encountering Europeans may have been unfamiliar with their particular forms of property ownership, but such unfamiliarity did not long survive extended contact between Europeans and Native Americans. In part these differences were the result of the differences between Europe and the Americas. For example, Europe was more crowded than the eastern seaboard of North America, and so land was scarce. Population estimates of the pre-contact populations vary wildly, but it seems clear that even the highest estimates put the population density well below contemporary European levels. As a result, land was more abundant than it was in Europe, so its allocation was less likely to be worth the effort to make boundaries and claims precise. But the scarce resources in any particular area, such as good hunting grounds, were the subject of property rights.

In short, many if not all of the pre-contact residents had their own well-developed systems of property rights before the arrival of Europeans. Those property rights evolved in response to European contact, with new rights delineated as trade with the Europeans made previously undelineated rights valuable.

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Harold Demsetz's classic 1967 article *Toward a Theory of Property Rights*, for example, showed how rights to beaver pelts developed among North American tribes in response to the European demand for fur.

The Europeans added a wide range of ideas about property to the mix. The European feudal tradition made property contingent on grants from the monarch. Vassals held their land, known as a "feud," on condition of providing service and homage to the lord above him. William the Conqueror brought feudalism to England, redistributing English estates to his supporters in 1066. (Nine of these received almost all the land in England.) The king could reclaim his property if the feudal tenant failed to comply with his obligation, committed treason, or died. In some parts of Europe this absolutist conception of property rights as dependent on the state survived relatively unchallenged. In *Property and Freedom* historian Richard Pipes ties the lack of political and economic liberty in tsarist Russia to the weakness of property rights in that society.

A second tradition, more friendly to liberty, also existed in Europe, one which saw property as independent of the monarchy and the state. Particularly in England, but also among groups of thinkers ranging from the Spanish Scholastics to those in the Dutch Republic, many Europeans saw property as a natural right. While Americans are most familiar with John Locke's statement of this argument in his *Second Treatise,* continental writers including Hugo Grotius and Samuel Pufendorf also developed influential natural-rights theories of property. Among the colonies in America this idea took strongest root in the North American English colonies. In particular, the Puritans argued that land was held not of the king but as a gift from God alone. As a result, the owners of these "allodial" (the opposite of feudal) land holdings owed no service to any lord.

American colonists from Britain brought with them both this natural-rights heritage and a significant set of common-law principles dealing with property in general and property in land in particular. In his 1765 essay *A Dissertation on the Canon and Feudal Law,* for example, John Adams argued that American land titles were not feudal. And Thomas Jefferson, in his 1774 instructions to the Virginia delegation to the Continental Congress, *A Summary View of the Rights of British America,* went even further, linking the colonists' allodial titles to Americans' "Saxon ancestors" who had held their land "in absolute dominion . . . disencumbered with any superior." For Jefferson and many others, the Norman Conquest had produced only a temporary exception to the English tradition of liberty and allodial ownership rather than a permanent reduction in rights.

Further, even with respect to the feudal institutions introduced by William the Conqueror, British land law had evolved—and the point that it *evolved* rather than developing through pronouncements from on high is important—into a complex set of arrangements that enabled individuals to engage in a wide range of property transactions. Land originally held "of" the king and transferred from generation to generation only by the king's grace became a commodity that the owner could sell and leave to his heirs without permission of the Crown. By the 1700s the evolution of English property toward more marketable forms had reached the point that the idea of an individual having a freehold estate in land independent of the government was both philosophically well grounded in natural law and practically established in property law.

There was nothing inevitable about an evolution toward property rights, as Russia demonstrates.

Evolution Was Not Inevitable

How did English property law come to evolve in this direction? There was nothing inevitable about an evolution toward property rights, as Russia demonstrates. Pipes has documented how Russian property rights withered under the sustained assault of the tsarist autocracy, leaving Russians dependent on the central government's forbearance rather than independent of the state.

There was no grand liberal design by the English aristocracy behind the evolution of property rights in England. Rather, two factors appear critical. First, the English crown was relatively poor and so dependent on

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the aristocracy for regular support. Even successful English monarchs like Elizabeth I struggled for funds. Elizabeth, for example, left her successor, James I, a virtually empty treasury containing only £200 and 3,000 dresses. Crucially, it was not England that was short of resources but the monarchy. Indeed, James, coming from impoverished Scotland, termed his arrival in England "a Christmas time" because of the far greater wealth he found there. This dependence forced even absolutist English monarchs such as the Stuarts to summon Parliaments and to regularly concede power to them simply to obtain the resources necessary to rule.

Second, England had a competitive system of courts. Multiple jurisdictions existed, including common-law and equity courts, merchant courts, and canon-law courts, each seeking business from litigants. This competition bred independence, giving litigants a fairer chance against the Crown in litigation than in many other European states. Further, the competition among courts allowed lawyers opportunities to develop tactics that brought their clients greater security of property rights. Indeed, legal historians agree that the primary focus of medieval common law was land law, what William Camden, a Stuart-period historian, summed up, saying, "[T]he declaring of the meum and tuum [mine and thine] . . . is the very object of the laws of England."

The result of this combination was supremacy of law. Parliament, courts, and lawyers regularly pushed the boundaries of royal power back, expanding liberty by protecting property rights in the pursuit of the resolution of private conflicts. The monarchy's need for cash forced England's kings and queens to repeatedly acquiesce in limits on their power. In both cases, because land was the key form of wealth, the result was strengthening of property rights and steady evolution toward higher estates.

The highest estate, and the form in which American land came to be held almost universally, was the fee simple. It included rights we often take for granted today but that were hard-won rights of Englishmen: the descent of land to the heir without reversion to the state, perpetual tenure, complete freedom to transfer by contract or will, the ability to change the use of the property, and freedom from "incidents uncertain," making the state of title known at the time of transfer. The ultimate result was, as Jonathan Hughes has written, to turn the American understanding of property "inside and out" by making property rights so complete that the Fifth Amendment did not even bother to specify the content of the rights it guaranteed.

Of course, Europeans brought not only natural-law justifications of property rights but also philosophical critiques of them. Both the Jamestown colonists and the Plymouth colonists initially attempted to hold property in common. In Jamestown land was to be held and managed collectively and each colonist was to receive an equal share of the colony's production regardless of his contribution. Two-thirds of the initial 104 colonists died of starvation and disease before the first winter, and the population, after soaring as hundreds of new colonists arrived from England, plummeted to 60 after the winter of 1609. When Governor Thomas Dale visited the colony in 1611 he found living skeletons bowling in the streets while fields went untended. After Dale partially converted the communal lands to individual three-acre tracts in 1614, productivity increased seven-fold. The remainder of the communal land was privatized by 1617.

Similarly, the Plymouth colonists began in 1620 with communal land and were near starvation when land was privatized in 1623. As William Bradford noted, the change "made all hands very industrious, so as much more corn was planted than otherwise would have been." Taken together, natural-rights theories, legal doctrines, and practical experience combined to give the American colonists a strong sense of the role of private property rights in ensuring their survival and prosperity.

Competing Claims to Property

The problem of establishing property rights in the New World rested not only on the relationship between individual and monarch but also on the relationship between monarchs. As Europeans began exploring the continent, competing claims to property in the Americas quickly appeared. Not only did various Native American tribes hold claims to different areas (and sometimes more than one had a claim to a particular area), but the European monarchs had conflicting claims to various territories. Individual European settlers also began to assert claims based on both the fact of their

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settlement or their own contracts with native peoples. Desiring to avoid conflicts over the new territories, the European powers reached an accord dividing much of the Americas among them. Spain and Portugal negotiated a partition of territory (based on a division by Pope Alexander VI). European powers more generally recognized a rule of discovery, granting to the European power that first found a new land the right to determine how to acquire the territory from the native inhabitants, whether by conquest or contract. The implementation of this principle varied from country to country. Britain generally prohibited individuals from making their own bargains with the native peoples, while France permitted such bargains.

Despite the claim to rights based on discovery, British colonists often acquired land by contract. For example, almost all of Massachusetts was acquired by purchase from local tribes. The primary exceptions there, Salem and Boston, were uninhabited areas, having been depopulated earlier by the diseases the colonists unwittingly brought with them. Although the British crown claimed the sole right to negotiate transfer of land rights from the Native Americans, many colonists thought otherwise and regularly made individual arrangements with various tribes to secure land. Such contracts led to one of the seminal cases in American land law, *Johnson v. M'Intosh*, an 1823 Supreme Court opinion by Chief Justice John Marshall that is still a foundation stone of law-school property classes. Although Marshall unfortunately sided with the state over the individual in that case, the principle of self-initiated land transactions proved hard to eradicate and continued as a means of establishing private property rights well into the nineteenth century as the frontier moved westward.

As noted, while European settlers brought their ideas about property to America, they also encountered something new here: vast tracts of fertile land. To acquire a parcel, one needed only to head west past the settled edge, find a desirable spot, possibly contract with a local tribe, and then build a farm. Instead of Europe's scarcity, America offered abundance. In 1800 an English laborer had to spend a third of his income to rent ten acres, while an American farm laborer could rent the same amount with only 1 percent of his income.

This abundance was not costless even if no cash had to change hands. Property-law casebooks used in the first year of law school often begin with a quote from John Locke's *Second Treatise*—"In the beginning all the world was America"—most often as a way of introducing the question of how property rights are initially established. However, Locke's point was not that America was unowned but that property's value depended on there being a means of storing value to encourage trade. In a world without money, he asked, what value would there be even for the best land? "[W]hat would a man value ten thousand, or an hundred thousand acres of excellent *land,* ready cultivated, and well stocked too with cattle, in the middle of the inland parts of *America,* where he had no hopes of commerce with other parts of the world, to draw *money* to him by the sale of the product? It would not be worth the enclosing, and we should see him give up again to the wild common of nature, whatever was more than would supply the conveniencies of life to be had there for him and his family."

> European powers more generally recognized a rule of discovery, granting to the European power that first found a new land the right to determine how to acquire the territory from the native inhabitants, whether by conquest or contract.

Only then did Locke say, "Thus in the beginning all the world was America, and more so than that is now; for no such thing as money was any where known. Find out something that hath the use and value of money amongst his neighbors, you shall see the same man will begin presently to enlarge his possessions."

Locke's grasp of Native American societies was questionable, for as noted earlier there is ample evidence that Indians had both well-developed property systems and

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measures of value. However, his central point that property was valuable only to the extent it was embedded in a market economy, where the goods produced on it could be exchanged for other goods, is critical to understanding the role of property in the economy.

The economic impact of secure property rights comes about because property makes possible positive-sum transactions between individuals. Those who own property will hire labor from those who do not, enriching both parties through trade. Likewise someone with property suited to growing apples will exchange with another whose property is suited for growing corn and is likely to do so on the property of a third person that is situated at a convenient crossroads between the apple orchard and cornfield.

Land's abundance in America also offered an important limit on the power of government. Fixed assets such as land have traditionally been vulnerable to expropriation and confiscatory taxation because it is hard for their owners to escape the state's grasp. In colonial America, excessive taxes could be readily evaded by moving west. Because property owners could move more readily than they could in Europe, American governments were constrained in their ability to tax.

America's vastness also offered enormous opportunities for land speculation. In *Our Enemy, The State,* libertarian writer Albert Jay Nock wrote that "land-speculation may be put down as the first major industry established in colonial America." While speculation can serve an entrepreneurial role, rewarding those who see possibilities in undeveloped land, it can also all too often become yet another exercise in political rent-seeking. Unfortunately, in many cases, land speculators in the New World were able to turn to governments to gain access to land resources or to locate valuable state institutions in such a way as to increase the value of their lands.

Property on the Frontier

English property concepts and law thus survived their transplant to American soil. Indeed they did more than survive; they thrived. As settlers pushed further west into new territories, they were faced with the problem of establishing property rights far from "civilization." They did so repeatedly, expanding first the colonies and ultimately the United States westward, as Jonathan Hughes put it, cutting settlements "into the wilderness primarily by privately motivated frontiersmen making small family farms acquired by purchase or homesteading."

Like many other aspirations of the new nation, the Northwest Ordinance's promises of fair treatment for Native Americans were ultimately unfulfilled, and the division of land in the Northwest Territory had its share of fraud and corruption.

After the Revolution, the new federal government faced the problem of determining how to govern the western territories the states ceded to it. Although it took until after the War of 1812 to finally settle all the U.S. land claims with Britain, even before then, American territory was advancing through the 1803 Louisiana Purchase.

Jefferson devised a system for the new lands, embodied first in the Ordinance of 1784 and then in the Northwest Ordinance of 1787. Not only did the ordinance create the mechanism by which territories could become states, it also explicitly guaranteed property rights. Following English law, the Northwest Ordinance provided for intergenerational land transfers both by will and by contract, with provisions that took into account the frontier difficulties in registering deeds with distant officials. The Ordinance also promised "the utmost good faith" toward the Indians, including within that term "that their lands and property shall never be taken from them without their consent; and, in their property, rights, and liberty, they shall never be invaded or disturbed, unless in just and lawful wars authorized by Congress. . . ."

Like many other aspirations of the new nation, the Northwest Ordinance's promises of fair treatment for Native Americans were ultimately unfulfilled, and the division of land in the Northwest Territory had its share

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of fraud and corruption. Ultimately, however, the combination of European notions of natural rights, the transformed and transplanted English common law of property, and American conditions led to the land's distribution into private hands with secure titles, forming the basis for the expansion of a free society westward.

When the modern Peruvian economist Hernando de Soto set out to discover why some nations were rich and some were poor, he found that the legal and economic experts he consulted could not satisfactorily explain the success of the West. One reason, he determined, was what he termed the "missing lessons of U.S. history." These lessons are not simply American, however, but universal lessons from history. What de Soto discovered was that the experts had failed to recognize the centrality of secure property rights in the development of the United States and the West in general. Rather, they mistakenly believed that prosperity grew out of the thicket of regulations and rules that exist today. Recapturing those missing lessons is important if we are to avoid inadvertently destroying the foundations of our freedom and prosperity. What then are the lessons of the colonial experience with property rights?

The first is simple: property matters. The second is the power of ideas. Property rights derived from British law and natural-rights philosophy developed into stronger, more effective guarantees of liberty over time. First in Britain and then in America, ideas introduced into the law evolved beyond their original, limited scope. Though gradual, this expansion of property rights ultimately produced a significant force for liberty.

Third, institutions that facilitate positive-sum transactions flourish. Such institutions produce peaceful and prosperous societies, a combination that is no accident. Property rights instantiate no particular vision of how property is to be used, leaving that to individual property owners to determine through voluntary transactions and so reducing social conflict over resources. Individual ownership in turn creates a powerful incentive for entrepreneurs who, envisioning a new, more valuable use for a piece of property, may purchase it and realize the gain. Change occurs peacefully in such circumstances because it is a byproduct of trade rather than the result of the decision of an autocrat. That peace and prosperity flow from property is the ultimate lesson, one that too few remember today.

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Aid, Trade, and Institutional Quality in Africa

BY JOSHUA C. HALL AND MATTHEW HISRICH

Screenwriter Richard Curtis received a great deal of attention for his 2005 movie *The Girl in the Café*. The film was the big-screen component of the Live 8 campaign, which included a deluge of media events and concerts around the world in an effort to increase aid to African countries and other developing nations at the approaching G-8 conference.

"I didn't give my life to politics in order to say that I was part of a generation that succeeded in cutting the tariff on the import of processed coffee to 27.3 percent," declares one of the movie's characters. "I want to be a member of that great generation that for the first time had in its power to wipe out poverty, and did so."

It's a powerful message, but is aid truly the best way to wipe out poverty in Africa?

Africa's growth problem is well documented. In a 1997 article in *The Quarterly Journal of Economics*, William Easterly and Ross Levine report that real per-capita GDP has been stagnant or declining in most African countries since 1960. Nearly all those countries had growth rates lower than the typical Asian country during this period, and many experienced economic decline. With the exception of some modest success stories such as Botswana and Lesotho, the view that Africa is a "growth tragedy" is sadly accurate.

This lack of growth has led to the impoverishment of hundreds of millions of people. Any attempt to remedy poverty in Africa must therefore focus on economic growth. The question of why some countries grow and others stagnate is at least as old as Adam Smith. In *The Wealth of Nations* Smith pointed to the quality of institutions, specifically economic freedom, as a factor in economic advance:

> The natural effort of every individual to better his own condition, when suffered to exert itself with freedom and security, is so powerful a principle, that it is alone, and without any assistance, not only capable of carrying on the society to wealth and prosperity, but of surmounting a hundred impertinent obstructions with which the follow of human laws too often encumbers its operations; though often the effect of these obstructions is always more or less either to encroach upon its freedom, or to diminish its security.

Peter Bauer and other economists have argued that foreign aid should be eliminated because of its deleterious effects on less-developed countries (LDCs) and that trade is the primary route to prosperity.

Historical and empirical evidence validates Smith's insight that economic freedom matters for development and prosperity. In a 2004 *Cato Journal* paper, for example, economists James Gwartney, Randall Holcombe, and Robert Lawson found that a one-unit increase in the economic-freedom index would raise per-capita GDP by 1.25 percentage

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points. Similarly, Jac Heckelman and Michael Stroup write in a 2000 *Kyklos* article that nearly half the differences in growth between countries can be explained by differences in economic freedom. Niclas Berggren surveyed the literature on economic freedom and growth in a 2003 issue of *The Independent Review* and concluded that an increase in economic freedom generally leads to growth.

This finding, however, does not give developed countries clear guidance on which policies to pursue. Even development economists who acknowledge the importance of institutions—such as Jeffrey Sachs—often remain vigorous proponents of increased government-to-government aid. Peter Bauer and other economists, however, have argued that foreign aid should be eliminated because of its deleterious effects on less-developed countries (LDCs) and that trade is the primary route to prosperity.

Both domestic and international trade are important for growth. Millions of Africans live at subsistence level, producing everything their households consume. Even where production above household consumption is possible, the absence of trading networks makes it impossible to convert higher production into a higher standard of living.

The opportunity to produce for the market creates an incentive to increase the supply of labor in a household. Given the low capital-to-labor ratio in most LDCs, a tiny increase in the supply of labor can result in a large increase in production. In addition, labor can be a form of capital formation. An example would be farmers forgoing leisure to clear and improve additional land for cultivation.

Trade also increases the supply of labor because of its reciprocal nature. In his 2000 book *From Subsistence to Exchange*, Bauer pointed out that trade is the impetus for economic advance because it brings the possibility of material improvement to people's attention. The availability of inexpensive but desirable goods because of trade provides a strong incentive to increase production.

Perhaps more important, the ability to produce for trade allows citizens of LDCs to benefit from specialization and the division of labor. Farmers no longer have to be concerned with producing everything their households need and instead can focus on growing cash crops such as cocoa. Specialization and the division of labor allow for the emergence of other productive enterprises. A final benefit of increased trade is the creation of trade networks. Trade networks lead to improved transportation routes and help to facilitate communication and dissemination of new ideas and innovations.

While developed countries that remove their import barriers cannot force LDCs to open their economies, they can increase the payoffs for doing so, thereby strengthening the incentive for institutional change.

Openness to Trade Leads to Growth

The empirical evidence that a country's openness to trade leads to prosperity is clear. Jeffrey Sachs and Andrew Warner find in a 1995 Brookings Institution paper that countries open to trade have average growth rates around 2.5 percentage points higher than countries closed to trade. In the *Economic Freedom of the World 2001 Annual Report,* James Gwartney, Robert Lawson, and Charles Skipton found that a one-unit change in a country's trade-openness index can increase long-term growth by two-tenths of a percentage point.

While developed countries that remove their import barriers cannot force LDCs to open their economies, they can increase the payoffs for doing so, thereby strengthening the incentive for institutional change.

As a matter of historical fact, aid is not a necessary condition for escape from poverty. Nearly the entire developed world was able to escape from subsistence level without aid. The important question for policymakers is the effect of aid on economic growth.

A review of the literature on aid and economic development shows that aid is unlikely to reverse Africa's growth tragedy because of the incentives it creates for rulers of African LDCs. While it is true that there are many types of foreign aid, the focus here is on cash and

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loans made directly by governments or organizations such as the IMF and World Bank. Regardless of where the aid comes from, though, it ultimately goes from one government to another.

Recall that a poor institutional environment is the primary reason for the low economic growth of these countries. In the long run, aid would only lead to economic growth if it created incentives for positive institutional reform. Yet aid creates exactly the opposite incentives. Government-to-government transfers create a moral hazard where rulers have little to no incentive to improve institutions because bad institutions lead to aid. In fact, rulers have a reason to make things worse in order to keep the aid coming.

The presence of government-to-government transfers in poorly governed countries creates what Bauer called the double asymmetry of foreign aid. On the one hand, aid as a percentage of GDP in these countries is relatively small and thus aid can do little to improve their situations. As a percentage of discretionary spending, however, aid is generally high. Thus the bad incentives discussed earlier dominate any good incentives that may exist.

The empirical literature on this topic is large and varied, with the current debate focused not on the general importance of aid but when aid might play a positive role. For example, Craig Burnside and David Dollar write in a 2000 *American Economic Review* article that aid is beneficial only in a good policy environment. While Easterly, Levine, and David Roodman called this finding into question in a 2003 follow-up article, it is important to note that nearly all African countries have bad policy environments. Thus even if the research of Burnside and Dollar is correct, this does not imply that aid to Africa will be beneficial. Increased aid in a poor policy environment is likely to make things worse given the perverse incentives.

How best to reduce poverty in Africa is a difficult question. Given that foreign aid is less than 1 percent of most donor countries' GDP, it seems like a simple and relatively inexpensive solution to African poverty. Calls for increased aid such as Live 8 therefore also seem reasonable. Considering the importance of institutions in economic development, however, maintaining or increasing aid hardly seems promising given the perverse incentives it creates for institutional reform. In fact, as Easterly shows in his 2001 book *The Elusive Quest for Growth*, experience demonstrates that aid does little to alleviate poverty and often retards economic development by making institutions even worse than they already were.

> As a matter of historical fact, aid is not a necessary condition for escape from poverty. Nearly the entire developed world was able to escape from subsistence level without aid.

While the citizens of developed countries cannot vote to change the institutional structure of African LDCs, they can pressure for the removal of their own barriers to trade. Doing so will increase the payoffs to production for international trade in Africa, which should increase internal pressure to make these countries more open to trade. Only through external contacts with developing countries will Africa be able to go from poverty to prosperity.

Indeed, as if in anticipating Richard Curtis and the Live 8 movement, 40 years ago the late Milton Friedman issued a clarion call for the elimination of poverty that rests on far more solid economic grounds. In the classic *Capitalism and Freedom* he wrote: "We could say to the rest of the world: We believe in freedom and intend to practice it. No one can force you to be free. That is your business. But we can offer you full cooperation on equal terms to all. Our market is open to you without tariffs or other restrictions. Sell here what you can and wish to. Use the proceeds to buy what you wish. In that way cooperation among individuals can be worldwide yet free."

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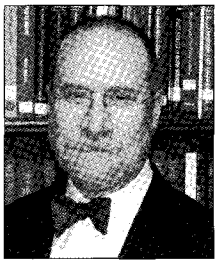

Global Warming and the Layman

BY SHELDON RICHMAN

Global warming is a divisive issue. People are either believers or skeptics, with each side viewing the other with apprehension. I've sided firmly with the skeptics, but lately I have had a nagging concern. Like most people, I am not an atmospheric scientist. I have no firsthand way to evaluate a scientifically based argument for or against the existence of global warming. So what grounds have I for believing what one scientist says against the thesis over what another one says in favor of it?

No good grounds at all.

I know why I have preferred the skeptical scientists and science writers, but the reasons aren't good ones because they aren't scientific. Instead they are based on extraneous things, such as the environmentalists' previous faulty record of predictions, or the typical statist approach to dealing with global warming, or the respective sides' presumed attitudes about industrialism.

It is true that many environmental nightmare scenarios are of doubtful worth because they are based more on bad economics than science. The overpopulation hysteria is one that thankfully has subsided. Likewise, predictions about the depletion of resources are refuted by sound economic theory and the "ultimate resource" arguments deployed by the late Julian Simon.

But a series of bad predictions doesn't mean the latest environmental prediction is necessarily wrong. For one thing, atmospheric scientists who warn about climate change are not necessarily the same people who warned about overpopulation and resource depletion. Moreover, even someone who has made bad predictions in the past (remember the global-cooling scare) may get the next one right.

More than a few reputable scientists see potential problems in the climate change that is occurring. The presence of shrill alarmists who oppose industrialism shouldn't overshadow them. Thus the issue needs to be evaluated on its merits. I know of no a priori reason to rule out the possibility that human activity is producing enough greenhouse gases to warm the atmosphere to an extent that will have bad consequences. That doesn't mean it's happening, just that it's not impossible.

For every factoid about ice sheets or sea levels or sun spots I can pull from the skeptics' literature, someone else can produce a counter-factoid. How is a nonscientist to decide which is accurate?

This is not to say the skeptics don't raise apparently compelling points. They do, and the believers should address them. But that still leaves the problem of how a layman is to sort the wheat from the chaff.

> There is nothing incoherent about favoring free markets *and* thinking that global warming is or may be a problem.

For advocates of individual liberty it is tempting to believe the skeptics are right because the other side is associated with statist solutions to climate change. Most solutions call for government control over the burning of fossil fuels. No advocate of free markets can be comfortable with a position that entails substantial taxes and subsidies to achieve a political objective—reduction of carbon emissions—especially when the solutions promise no more than negligible reductions in temperature. (Temperature, not emissions per se, is supposed to be the believers' cause for concern.)

But picking sides in a scientific debate on the basis of proposed remedies is the wrong way to go about things. A believer in global warming could get the science right but the remedy wrong. That government shouldn't ban

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smoking doesn't mean smoking isn't bad for you. There is nothing incoherent about favoring free markets *and* thinking that global warming is or may be a problem.

Liberals should be careful about accepting the environmentalists' package deal. Do we really want to concede up front that there are only statist solutions to the possible threat from climate change? That would betray a lack of confidence in the freedom philosophy and the market process.

Skeptics often portray believers in global warming as anti-industrial, anti-free-market zealots who shelve objectivity because they want to usher in an era of primitivism and totalitarian control. Maybe some of them are and do. But all of them? That's hard to believe.

Skeptics also attribute the preponderance of research supporting the believers' thesis to the corrupting influence of government finance. I have no trouble believing that the politicization of scientific research creates an advantage for doomsayers. Power isn't likely to flow from benign findings. But does that in itself mean all gloomy forecasts about climate change must be wrong? I don't think so. It strains credulity to think that every scientist who believes hazardous manmade global warming is happening has prostituted himself for a government grant. To prove that unlikely charge you need more than abstract arguments about perverse incentives. Assuming good faith in one's opponents seems a more fruitful approach.

So we're back to my question. How can someone without a great deal of atmospheric knowledge cherry-pick from the reams of positive and negative claims about global warming?

Some things seem reasonable to accept: first, that the earth is warming and, second, that human activity is partly responsible. Most scientists associated with skepticism acknowledge these points. The open question in both cases is: how much? Another question is whether the effects of climate change will be good, bad, or a mixture of good and bad. On both questions I am in no position to say. Maybe no one is—not even eminent climatologists—at least not today.

Empirical Questions

This much I know: these are highly complex *empirical* questions. They are not a political, ethical, or ideological questions. Thus the answers must be left to the scientific process, preferably untainted by government control.

In the meantime, laymen committed to individual freedom have their own question to attend to: *If* potentially harmful manmade climate change is occurring, how can it be addressed without violating liberty? Our energy should be invested in answering that question. A good start is made in a series of articles by Shikha Dalmia, Donald Boudreaux, and Julian Morris published by the Reason Foundation (online at www.reason.org/roundtable/). I also recommend the thought-provoking paper by Edwin Dolan, published in the Fall 2006 issue of *The Cato Journal* (online at www.cato.org/pubs/journal/cj26n3/cj26n3-3.pdf).

The free-market literature is filled with reasons to lack confidence in government solutions to environmental problems. Those reasons include the perverse incentives and inadequate knowledge that pervade all political processes. Any bureaucratic program will be corrupted by power, privilege, and incompetence. So now is the time for us libertarians to direct our unique philosophy toward grappling with potential climate hazards in a manner consistent with freedom and the requirements for prosperity.

Why freedom? Because being able to lead a self-directed life is too important to trade away for the faint promise of a cooler climate (assuming we even want that).

And why prosperity? Because poverty kills—we can be certain of that—and wealth makes us resilient.

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Open-Source Software: Who Needs Intellectual Property?

BY MICHELE BOLDRIN AND DAVID K. LEVINE

The market for open-source software—uncopyrighted, freely reproducible computer programs—is not well understood by economists. A central source of surprise is that innovation can thrive in a market without traditional intellectual property (IP). But as we argued in a 2005 unpublished paper, "Perfectly Competitive Innovation," as a matter of theory there is no reason to believe that monopoly power through IP is needed for innovation. The market for open-source software is the poster child for this perspective.

First, understand that the market for open-source software is a classic example of a competitive market. It is characterized by the voluntary renunciation of copyright and patent. Buyers are entitled to make their own copies, modified or not, and sell them. "Free software" in this context means "free as in freedom, not free as in beer." There is also voluntary renunciation of trade secrecy: the original creator publishes the source code—the "blueprint" for producing the software—along with the software itself. Some open-source software has the further requirement that as a condition of use, buyers make their modification available under the same terms. The open-source movement has been called everything from a virus to socialism—so it may or may not be surprising to hear it called a model of a fully competitive market. Yet that is what it is, as much so as the market for wheat. All purchasers of software can compete with the seller and one another, and often they do.

Given that there are fixed costs of producing software and (it is commonly thought) competition drives profits to zero, how does this market function? How are the fixed costs covered? In the absence of profits from monopoly power, the source of income used to pay fixed costs is competitive returns. We will investigate three issues here. First, what is the source of the competitive returns that pay the bills of software developers? Second, is the market a real market? That is, do software producers in fact get adequate compensation for the fixed costs of their efforts? Or is open-source software, as is sometimes alleged, simply an elaborate altruistic charity? Finally, we ask how significant the open-source software market is. Is it a thriving source of innovation, or just a free-rider off the innovations of more traditional closed-source IP-protected software, making cheap imitations that never would have been produced in the first place absent monopoly power?

The evidence (and the common sense of anyone involved with open-source software) shows that the source of competitive returns that pay the bills of software developers is the complementary sale of expertise. To earn a return through the sale of something, it must be something scarce. Copies of software may be scarce, but we shall see that the actual duplication of copies is sufficiently quick and inexpensive that only small returns can be obtained through the sale of copies. However, purchasers of copies of software programs also have a demand for services—ranging from support and consulting to customization. They naturally prefer to hire the creators of the programs, who in the process of writing the software have developed specialized expertise that is not so easily matched by imitators.

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To understand the sources of competitive returns in this market, it is helpful to look at an example. A leading and profitable open-source software firm is Red Hat, a company that sells the computer operating system GNU/Linux, a modified and customized version of the underlying Linux system, with many features that can be optionally installed. Although the base system is in principle obtained by Red Hat for free, in fact it pays the developers. Alan Cox, one of the main kernel developers, works for Red Hat. The firm is also a contributor to the Open Source Development Labs, which employs Linus Torvalds, the developer of Linux. In addition Torvalds benefited from a substantial "gift" of stock options from Red Hat. Beyond this, the customization and testing conducted by Red Hat is costly. So Red Hat faces a substantial fixed cost of providing its software.

Let us first consider returns earned through the sale of physical copies. In this market physical copies of software sell for greater than marginal cost. Using prices quoted on the Internet on July 10, 2002, Red Hat charged $59.95 for a package containing its system. Because it is based on Linux, competitors can legally duplicate and sell the exact same Red Hat system. In fact, at least two companies, Hcidesign and Linuxemporium, did exactly this. On July 10, 2002, Hcidesign offered for sale Red Hat Linux 7.2 for $16, about a third the price charged by Red Hat. Linuxemporium.co.uk offered a similar deal. The striking fact is that Red Hat sold many more packages at $59.95 than Hcidesign and Linuxemporium did at $16. Neither company ever represented a threat to Red Hat.

Notice that the premium charged by Red Hat was not likely due to the physical scarcity of copies. Rather, it was for the sale of expertise that came with developing the system. Anyone who uses computer software knows that it rarely functions as expected. If you buy software and have a question or problem, whom would you prefer to call? The people who wrote and developed the program? Or the people who duplicated the CD?

> The evidence shows that the source of competitive returns that pay the bills of software developers is the complementary sale of expertise.

A Better Business Model

In fact, selling expertise by charging a premium on physical copies has not turned out to be the most successful business model. Red Hat eventually concluded that it was not selling enough $59.95 copies and switched strategies. What had previously been sold is now given away for free as Fedora Core and is used as a platform to get feedback on features that are incorporated into the commercial system called Red Hat Enterprise Linux. The latter is available only by annual subscription at a price that—depending on features—ranges from $349 to $2,499.

This blurb from the Red Hat website's promotional material makes clear what customers are paying for: "Unlimited access to service and support: Subscriptions include ongoing service and support to guarantee your systems remain secure, reliable, and up-to-date. When you have a technical question, you'll speak to Red Hat Certified Software Engineers. Or you can access a self-serve knowledge base of technical information and updates."

Notice how this market works: First expertise is passed from the developers to Red Hat Certified Software Engineers. Then others acquire the expertise, the stock of expertise expands, and the price at which it can be sold drops. Of course, in the meantime innovations are created, and new expertise is generated.

The presence of profitable firms such as Red Hat—not to speak of IBM—in the open-source industry suggests that it is a viable concern and not a charitable or altruistic activity. In their 2004 paper "The Economics of Technology Sharing: Open Source and Beyond," Josh Lerner and Jean Tirole documented some of the financial benefit to individual developers of contributing to open-source projects. For example, the team of programmers that developed the Apache web server are ranked according to the significance of their contributions and hold other jobs. Work by Il-Horn Hann et al. shows that the salaries the programmers receive in these other jobs are heavily influenced by their rank within the Apache Foundation. In other words, the "expertise"

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model at Apache is much like that in academia—the programmer writes software in order to receive recognition and financial payment for the expertise he demonstrates through his published product.

Examination of particular individual developers reinforces this point. Torvalds is a multimillionaire, and Bram Cohen, the developer of BitTorrent, recently received $8.75 million in venture capital for his open-source project. These figures and the success of open-source software also teach us something important about the (expected) payments needed to get smart people like Torvalds or Cohen to develop innovative software. It is unlikely that Torvalds originally wrote Linux with the aim of becoming a multimillionaire. Still, he must have hoped for some revenue stream when starting his work. His current wealth is probably higher than he expected. Still it is four orders of magnitude less than that of Bill Gates. Hence, at least in the case of Torvalds, the opportunity cost for writing innovative software is not in the tens of billion of dollars, but just in the millions. This is worth keeping in mind when someone claims that without the huge monopoly rents through IP, innovators would not be innovating.

Finally, it is possible to imagine that the open-source industry is not a real industry at all. Perhaps it exists only because it is able to free-ride off the innovations created in the proprietary part of the industry, in which the monopoly power of copyright plays a key role. It is certainly true that Linux is a knock-off of Unix and that OpenOffice Writer is a knock-off of Microsoft Word. But this means little, because practically all software, proprietary or not, is an imitation of some other software. Microsoft Windows is an imitation of the Macintosh, which is an imitation of Smalltalk. Microsoft Word is an imitation of WordPerfect, which is an imitation of WordStar. Microsoft Excel is an imitation of Lotus 1-2-3, which was an imitation of VisiCalc. And so on.

But is the free-rider argument correct?

Consider word-processing. Many open-source alternatives to Microsoft Word exist, including Kword, AbiWord, and OpenOffice Writer, the latter being the most widely used. How did the cost of developing this software—financed as it was by an open-source model—compare to the cost of developing Microsoft Word? The fact is that most of the cost of writing software is not in the observation that it might be nice to have a button to justify text or in the algorithms for spacing lines—which after all were developed by Gutenberg back in 1450—but rather in the detailed implementation and debugging of computer code. As far as we know, none of these open-source projects benefited at all from the work done by Microsoft.

More Expensive to Develop

Indeed, the development of these open-source projects was probably more expensive than the development of Microsoft Word. The most difficult and expensive programming tasks faced by the developers of these projects appear to be reverse engineering of Microsoft Word documents and providing compatible formatting capability so that documents can be exchanged with Microsoft Word. Had these projects gone first, this substantial cost would have been avoided.

It is also worth noting that the competitive returns generated by these projects are significantly smaller than they would have been had they hit the market before Microsoft Word did. So it seems reasonable to conclude that the competitive market without Microsoft Word would have delivered both these programs.

Probably the most innovative program in the last few years is BitTorrent, a program that decentralizes and vastly increases the speed at which very large files can be downloaded off the Internet. It is commercially successful in the sense that 50,000 copies a day are downloaded. It is also sufficiently innovative that it is now being imitated—by Microsoft. BitTorrent, however, is open-source, and according to its website, author Bram Cohen maintains the program for a living.

The final point to emphasize here is that the market for software is not unique. Innovation and competition unprotected by patent and copyright have gone hand in hand in other industries, from financial securities to fashion. The message of open-source software is a message for all industries: IP not needed for innovation here.

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Monetary-Policy Disasters of the Twentieth Century

BY KIRBY R. CUNDIFF

The Federal Reserve System was created in 1913 and soon did what central banks almost always do: it started printing lots of money. During World War I the Bank of England inflated its money supply, and as a result a significant amount of gold flowed out of Great Britain to the United States in the 1920s. Instead of controlling their monetary expansion, the British authorities put pressure on the U.S. government to expand its own money supply. The Fed happily complied and engaged in significant monetary inflation throughout most of the decade. This extra liquidity helped fuel the stock-market boom, but by 1928 it was obvious that monetary expansion had gone too far, and the Fed changed course. What ensued was a massive contraction of the money supply, followed by many years of incoherent and incompetent monetary policy that strongly contributed to the length and severity of the Great Depression.

When the Federal Reserve started restraining the money supply, stock-market growth declined and soon a pull-back developed. In the 1920s the use of debt by both banks and individuals to invest in the stock market was common. Today Federal Reserve margin requirements limit debt for stock for purchases to 50 percent. But during the 1920s leverage rates of up to 90 percent debt were not uncommon. When the stock market started to contract, many individuals received margin calls. They had to deliver more money to their brokers or their shares would be sold. Since many individuals did not have the equity to cover their margin positions, their shares were sold, causing further market declines and further margin calls. The stock market crash of 1929 was the result.

In the 1920s banks were allowed to invest their assets in the stock market, so many banks went bankrupt as well. The Glass-Steagall Act of 1933, one of the many new Depression-era banking regulations, made equity positions for banks illegal. This act split banks into two types: commercial banks and investment banks. (This law was repealed in 1999.)

The events of 1929, largely caused by government intervention in the economy, were used as an excuse for much more government intervention in the economy. Because of the extreme overprinting of money during the 1920s, the Fed had nowhere near the amount of gold necessary to cover all the claims it had printed. The American people were wise enough not to trust the banking system and attempted to get their gold out of America's banks. The Roosevelt administration responded by closing down the banks (declaring a banking holiday) and defaulting on the gold standard. In 1933 President Roosevelt signed Executive Order 6102 making private ownership of gold for investment purposes in the United States illegal. Roosevelt also seized most of the American citizens' gold coins, melted them down, and put them in Fort Knox.

At the Bretton Woods conference in 1944 the world was again temporarily on something resembling the gold standard. All the world's major currencies were fixed to the dollar, and the dollar was fixed to gold. An ounce of gold was supposed to be worth $35 forever after. The U.S. central bank then proceeded again to print too much money. Throughout the 1960s various European central banks, particularly the French,

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redeemed their dollars for gold. The United States had too little gold to meet the demand, so in August 1971 President Richard Nixon suspended convertibility of the dollar and defaulted on the Bretton Woods agreement. The gold standard was abandoned, and currencies soon floated against each other.

The leaders of the Federal Reserve System did not learn from this experience. They still kept overprinting money, and the Consumer Price Index (CPI) continued to climb. (An increase in the CPI is often, misleadingly, called the inflation rate. Other things equal, inflating the money supply sets off a general rise in prices.) In 1960 the CPI increased less than 1 percent, but by 1970 it was up to over 5 percent. Predictably, political leaders addressed the effects, not cause. In 1971 Nixon tried to outlaw the symptoms of inflation by imposing wage and price controls. In 1974 his successor, Gerald Ford, launched the WIN (Whip Inflation Now) campaign, but the "printing presses" kept running and inflation kept increasing. In 1980, under President Jimmy Carter, the "inflation rate" peaked at over 12 percent. While this was high by U.S. standards, other countries fared far worse. In 1985 the annual increase in Bolivia reached 11,749 percent, in Argentina 672 percent, and in Brazil 227 percent.

As inflation raged, purchasing power evaporated. Nominal wage increases and profits were illusory, wreaking havoc with people's ability to do economic calculations and pushing them into higher income-tax brackets. When market participants came to expect inflation, the economy slowed down and unemployment increased, even as prices continued rising. This was the supposedly impossible "stagflation" of the late 1970s.

Excessive monetary expansion resulted in another financial disaster in the latter part of the twentieth century—the savings-and-loan fiasco. This was the largest banking failure in U.S. history. Over 1,000 S&Ls failed, resulting in the bankruptcy of the Federal Saving and Loan Insurance Corporation (FSLIC) and a loss of over $150 billion, of which over $120 billion was covered by the U.S. taxpayers. Many culprits have been blamed for this banking disaster, from junk bonds to greedy and corrupt banking officials, but the primary reason for the widespread failures in the industry was irresponsible monetary policy at the Fed.

By law S&Ls could only invest in 30-year fixed-rate home mortgages. The main source of their funds were savings accounts from which depositors could withdraw their money anytime. This led to what is known as a duration mismatch. During the low-inflation periods of the 1950s and 1960s, the S&Ls made many 30-year fixed-rate loans that were still outstanding in the 1970s and 1980s. But when prices were rising 12 percent a year, while an S&L's mortgages yielded only 6 percent and its savings accounts paid only 5.5 percent, something had to give.

The reason S&L accounts paid only 5.5 percent was the government's Regulation Q, which imposed interest ceilings on savers. Meanwhile U.S. Treasury bills were yielding over 8 percent in 1970 and over 15 percent around 1980. But to buy a T-bill an investor needed $10,000. Thus rich people could shift their money from savings accounts to T-bills, but those without $10,000 were stuck. Fortunately, the money-market mutual fund emerged in 1971. This type of account allowed people to pool their money with other small investors and together purchase T-bills and commercial paper. Now small investors could also purchase high-yield short-term investments.

With small depositors moving their money from savings accounts to money-market funds, a process called disintermediation, the S&Ls were in trouble. They responded by offering toasters and other giveaways to attract customers, but that did not work, and massive bankruptcies ensued. In 1982 the Garn-St. Germain Act legalized money-market mutual funds without an interest-rate ceiling.

Volcker to the Fed

In 1979 Jimmy Carter appointed Paul Volcker to head the Federal Reserve. Volcker did what he said he was going to do. He drastically increased short-term interest rates to control inflation. In 1980 short-term interest rates were much higher than long-term interest rates. Since S&Ls made their money by borrowing short and lending long this contributed further to their destruction. By 1982 the "inflation rate" had dropped to around 4.25 percent, but many S&Ls were bankrupt, with total losses of over $100 billion. In a desperate effort to fix the problem federal regulators allowed the S&Ls to engage

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in questionable accounting practices and more risky (and hopefully) more profitable investments. It did not work, and by the end of the 1980s S&L losses had risen to over $150 billion. Since the liabilities (depositors' money) were federally insured, the taxpayers had to pick up much of the tab. Finally, in the late 1980s and early 1990s the insolvent S&Ls were shut down. With the price index back to normal, stability gradually returned to the financial markets. In 1982 one of the greatest bull markets in U.S. history began and continued until 2000. While inflation measured by the consumer price index has been relatively mild in the United States since the early 1980s, the money supply has continued to expand at a rapid rate. It is likely that this expansion contributed to the stock-market bubble of the late 1990s and the housing boom of the early 2000s.

Not everyone benefited from the restabilization of the financial markets. In societies where the currency is unstable people naturally turn to other stores of wealth. Gold and real estate are common investments, and the United States during the 1970s was no exception. While the stock market floundered during the 1970s, the real-estate market boomed. The increase in real-estate values included not only houses but also farmland. When the price of farmland increased, farmers in the Midwest were able to take out larger bank loans and drastically expand their operations. But when real-estate prices declined, the leverage ratios on farms drastically increased. During the 1980s many farm bankruptcies followed.

The Great Depression of the 1930s, the S&L fiasco of the 1980s and 1990s, and the farming crisis of the 1980s are all testaments to the extremely destructive effects that an irresponsible monetary policy can have on a society. Policymakers allegedly created the Fed to prevent these sorts of problems. Official goals of the system include maximizing employment, stabilizing prices, and maintaining moderate long-term interest rates. (See www.federalreserve.gov/pf/pdf/pf_2.pdf.) It is interesting to note, however, that the only extended periods when the U.S. economy did not experience significant inflation occurred when the United States had no central banking system.

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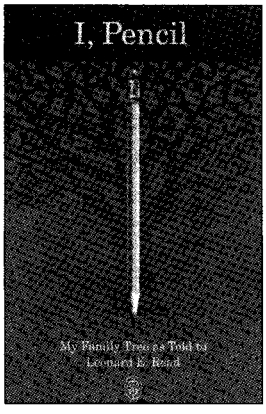

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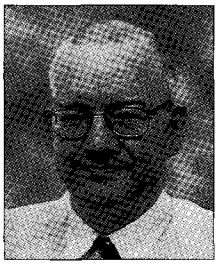

A Different Story

BY STEPHEN DAVIES

In the days when there was still a pretense that the public school system was actually concerned with education, one of the main elements of instruction was to make sure that pupils could remember a series of important historical dates and their significance. It was thought that everyone should know why dates such as 1492, 1776, 1815, and 1914 were worth remembering.

The reason for this was that such dates and the events associated with them formed part of a complex narrative that it was thought all educated people should understand. Such understanding was desirable because the narrative explained how important aspects of the world came to be and so made sense of the present. The dates identified what were seen as crucial events, ones that had extensive effects and so shaped and determined what followed. They marked major turning points or moments of decision in the course of history.

The nature and content of the historical narrative can be deduced from the dates and events that were given prominence. Almost without exception they involved episodes in war and revolution, the deaths or triumphs of major political figures, and events that, while not political in themselves, had major impacts on political events (the voyage of Columbus for example). In other words, the world we live in is seen to be mainly the outcome of politics, wars, and the careers of rulers.

Obviously there is a great deal of truth in this. Politics and power do indeed have far-reaching effects on people's lives in a dramatic way. However, the view of history, and of human social life more generally, that we get from the classic lists of important dates is partial and distorted. Other kinds of narrative can be constructed that would yield a very different list. One might emphasize the role of ideas and knowledge in human affairs. From that point of view 1776 would be memorable not so much for the American Revolution as the publication of *The Wealth of Nations*. The most important event in the history of seventeenth-century Europe would not be the Treaty of Westphalia (1648) but the publication of Newton's *Principia Mathematica* (1687).

In fact we can go even further. Maybe there are other dates associated with other kinds of events that are actually more significant than those that mark the course of political power. It may be that it is not power that is the fundamental driving force in the history and evolution of human society but something else. The revealing point is that the key dates in that alternative story are almost unknown to the public, and the understanding of human society and history that goes with it is seldom even formulated and articulated.

One example of a very important date in this kind of narrative is January 22, 1970. That day saw the first passenger-carrying flight of the Boeing 747, the jumbo jet, from New York to London. This was the culmination of years of work by Boeing, and it marked a revolutionary transformation in the nature of air travel. Before then air travel had been expensive and planes could not carry significant cargo loads or numbers of passengers. Although air transport had become prominent following earlier technical breakthroughs (notably the production of the Dakota), it was still not a regular part of most people's lives and had a correspondingly limited impact on human affairs. The Boeing 747 changed all of this and in a very short time. Within six months of that first flight 747s had carried one million passengers, and after only one year, there were a hundred in operation and the number of passengers had risen to seven million. Other manufacturers soon tried to enter the market that Boeing had discovered, and the era of the wide-bodied jet airliner and mass air transport arrived.

The significance of that date can be understood by trying to imagine what the world would be like if we were to revert to the limited use of long-distance air

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travel that was the norm before 1970 and how much of what we now take for granted would change or vanish. (This is not simply a thought experiment—there are loud voices urging exactly this course of action.) Several important features of the contemporary world, such as mass long-distance tourism, are only possible because of the revolution begun on that day in 1970. In general we can say that the peoples of the world are much more closely connected than they were before. Trips to other parts of the world that would previously have been major undertakings are now routine. Much modern business and trade depend on the ease and low cost of modern long-distance air travel. For billions of people the world has shrunk, and contact between different parts of the world has become simpler and cheaper. This has brought about much greater cultural and intellectual contact between different peoples and cultures.

Another date that would find a prominent place on this alternative list is April 26, 1956. That day the first containership left Newark for Houston. It was the brainchild of an entrepreneur called Malcom McLean. As a young man running a trucking firm, he realized that the main cause of delay in moving goods was not the actual shipping but the transhipping from one mode of transport to another. His simple yet brilliant solution was the metal container and the containership. The immediate effects of this were dramatic, reducing costs 35-fold. In the long run the container played a crucial part in the great surge of economic integration (known as globalization) that occurred in the late twentieth century and so contributed to a massive rise in living standards for millions of people worldwide. A hundred years earlier, inventions such as the railroad, the iron-hulled steamship, the freezer ship, and the telegraph had driven the great economic transformation of the second half of the nineteenth century, which brought about an unprecedented rise in real incomes and living standards.

Growth of Trade

Dates such as these mark key points in a very different narrative from the one that concentrates on power and its workings. This other narrative traces the growth of trade, the interconnections between more and more people, and the greater part of productive activity over an ever-larger portion of the planet's surface. Aspects of this story are the discovery of previously unknown wants, a steady growth in the range of possibilities and opportunities open to ordinary people, a massive improvement in living conditions, and the mutual exchange of ideas and cultural expressions between the various parts of the world to their mutual enrichment.

The other narrative traces the growth of trade, the interconnections between more and more people, and the greater part of productive activity over an ever-larger portion of the planet's surface.

However, because this narrative is not spelled out and its key dates are mostly unknown, we are generally unaware of it. The process it traces and its benefits are taken for granted and assumed to be natural. If we do stop and think about it, however, we will see the world and the course of human history differently from how the narrative of power would have us see it. We should realize that what is important for the everyday life and hopes of ordinary people is not power but peaceful cooperation and exchange. Not everyone welcomes this. There are those who would decry increased affluence, regret the easier movement of people, and deplore cultural mixing and exchange. We should ignore them and reject their argument.

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The Sovereign Presidency: Is This What the Framers Had in Mind?

BY JOSEPH R. STROMBERG

"Well, when the president does it that means it is not illegal."
—Richard Nixon, interviewed by David Frost, May 19, 1977

American government under the Constitution was supposedly meant to work as follows: Congress, staying within delegated powers and the Bill of Rights, passes laws; the president executes the laws; and the courts sort out ensuing wrangles. This plan ran aground rather early—the 1798 Alien and Sedition Acts, for example—which raises at least two possibilities: 1) The Federalist movement systematically misrepresented its project or 2) the framers' well-meant "design" fell short of their goals. Figuring this out is difficult, with original sin, human nature, foreign complications, and more tangling up the causal chain.

Even so, the Constitution—read anywhere near its apparent intent—might be worth hanging onto; but how can we get such a reading? Enter a new crop of "conservative" legalists to offer us one under the rubric of "originalism."

For this crop of presidentialists, which includes John C. Yoo, Roger J. Delahunty, David Addington, Jay S. Bybee, and Attorney General Alberto Gonzales, originalism centers on the Unitary Executive Theory (UET)—a bizarre doctrine of presidential infallibility allegedly prefigured by Alexander Hamilton. Under the UET, America's president is utterly sovereign in his sphere and sole judge of his own powers.

The merest glance at America's founding suggests that *no one* really wanted full-bore elective despotism. Nonetheless, American presidentialists apparently find just that in the terms "war powers" and "commander-in-chief," and in presidential dominance of foreign affairs. Yet their forebear Hamilton conceded that in war the president has "nothing more than the supreme command and direction of the military and naval forces, as first General and Admiral of the Confederacy" (Federalist 69).

The merest glance at America's founding suggests that no one really wanted full-bore elective despotism.

Presidentialists take John Marshall's comment, in Congress, that the president is our "sole organ of communication" with other nations as entailing lots of power. And always, presidents *assert* powers and store up precedents. Presidentialists turn presidential *duties*, chores, and everyday practices into powers, and strong figures have built the office.

In the Mexican War (1846–48), President James Polk established the *practical* precedent of maneuvering Congress into war. But it was Abraham Lincoln, above all, who asserted immeasurable war powers belonging (mostly) to the president, by combining the commander-in-chief clause with the president's job of enforcing the laws. Of this, legal historian Raoul Berger writes in *Executive Privilege*: "[W]hen nothing is added to nothing the sum remains nothing." But success succeeds, and later presidents—Richard Nixon and George W. Bush among them—have

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eagerly wrapped themselves in Lincoln's mantle of effectively suspending the Constitution to save the country.

After Lincoln presidential war powers rested up until 1898, when President William McKinley wielded them overseas. (McKinley issued a virtual ultimatum to Spain over Cuba a month before Congress declared war.) Theodore Roosevelt thought he could do anything *not prohibited*, at home and abroad, thereby neatly reversing the premise on which the Constitution was sold. Woodrow Wilson, too, had large views, but in 1917–1918 amiably shared with Congress the power of treading liberty under foot (conscription, for example), albeit with no new doctrines, merely existing bad ones.

Worse luck, in *United States v. Curtiss-Wright Export Co.* (1936), conservative Supreme Court Justice George Sutherland fancied that during our revolution, George III's prerogative powers somehow lighted on the union, hovering, extra-constitutionally, above successive Congresses, descending finally on the presidency. Berger deconstructed *Curtiss-Wright*, underscoring the *break* with England and the resulting institutional discontinuity. Sutherland's opinion stands, approvingly cited by UE theorists.

As Berger notes, Sutherland championed "a theory of inherent presidential power over foreign relations." Berger quotes Louis Henkin, who adds that Sutherland's assertion "carves a broad exception in the historic conception . . . never questioned and explicitly reaffirmed in the Tenth Amendment, that the federal government is one of enumerated powers only."

Presidential power made great strides under Franklin Roosevelt, before and during World War II. FDR's domestic emergencies and his wartime operations added much to the office. The Cold War extended these power-accumulations into an indefinite and interesting future.

The Supreme Court's decision in *Youngstown Sheet & Tube Co. v. Sawyer* (1952), during the Korean War, reflected existing realities. Briefly, President Harry Truman, citing war powers, seized the steel industry to end a strike. People across the political spectrum, from organized labor to Republican Senator Robert Taft, denounced the action. The Supreme Court dodged the issue, holding that presidential powers did not go *quite as far* as Truman thought.

Bottomless Well of Power

Presidentialists take "The executive power shall be vested" (Article II) for a bottomless well. They see the specific duties mentioned as *additional grants of power* open to further (perhaps tortured) interpretation. They find further "*inherent* powers" arising from international law and Marshall's sole organhood, and read the oath—"faithfully execute the office" and "preserve, protect, and defend the Constitution"—as allowing the president to *violate* laws in defense of the Constitution. Yet the charge that the president "take care that the laws be faithfully executed" (Article II, Section 3) seems to prohibit such maneuvers, although presidents have bent the words to their purposes, as when Lincoln "combined" them with the commander-in-chief provision.

Presidential lawyers aggregate or separate clauses to widen power. Political scientist Richard M. Pious writes in *American Presidency* that presidential lawyers, construing *congressional* powers strictly, view "all remaining functions, powers, and duties [as] exercised by the president under doctrines of inherent powers, resulting powers, sovereign powers, and inclusions"—along with emergency and national-security powers. Finally, presidents —as a branch of government—assert a right to interpret the Constitution. Pious shows minimal respect for these notions, commenting that recent, barely elected presidents have felt a need to exploit their "legal" opportunities.

From 1947 on, anticommunist crusading fostered *right-wing* presidentialism. Meanwhile, on other issues the Supreme Court provoked a reaction toward strict construction. Since that was quite incompatible with Cold War policies, something had to give; when it did, right-wing presidentialists hijacked strict construction, reinventing it as absolutist originalism. Midway through this journey, Richard Nixon's cries of "national security"—to becloud the Watergate affair—rang like a fire bell in the day.

In his online paper "Rethinking Presidential Power—The Unitary Executive and the George W. Bush Presidency," political scientist Christopher S. Kelley writes that, frustrated by ongoing congressional "aggression" against executive power—the War Powers Act of 1973 and congressional "interference" with federal bureaucracies—lawyers in the Justice Department's

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Office of Legal Counsel cobbled UE theory together in the 1980s. During war—as everyone "knows"—the feds may freeze the Bill of Rights, provided they thaw it out later. What seems new in UE theory is the assertion that the president is *sole judge* of his powers, with Congress and courts excluded from inquiring into executive undertakings. (Nixon claimed to be sole judge of executive privilege.) This would seem a recipe for tyranny.

UE theorists speak of constitutional text, structure, and history; but their postmodern textual maneuvers, their homemade structures, and their lawyer's history live on the edge of sudden implosion. In a 2003 paper, "Judicial Review and the War on Terrorism," John Yoo, who had worked in the Bush 43 Office of Legal Counsel, asserted that while the judicial process exists for issues involving federalism, none exists for issues arising from war. He thereby nodded toward UE theorists' oft-professed belief in states' rights while separating all such "domestic" matters from important presidential activities. Yoo praised "the war powers system we have today in which the President initiates war, Congress funds it, and the courts remain aloof." Further, the president may designate citizens as enemies, with no further proof or process needed.

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Elsewhere, in "The President's Constitutional Authority to Conduct Military Operations against Terrorist Organizations and the Nations that Harbor or Support Them," Yoo and Roger Delahunty examine Article II of the Constitution where they see the mere words "the executive power shall be vested in a President"—the high-toned "Vesting Clause"—as unveiling a mighty fortress: "*The* executive power" (my emphasis). The authors assign the president "all of the executive power" and "full control" of the military, adducing his power to "repel sudden attacks," commending his "speed and energy." Predictably, they hold that Congress has *only* powers "herein granted" and "enumerated," while the president has "all *other* unenumerated powers." Backed by "historical practice" and "precedent," "the President alone" decides war and peace. This is textualism?

The shades of Wilson, FDR, and Truman must be smiling. Few non-White House supremacists would read texts so *liberally*. A whole generation of conservative constitutionalists now *surpasses* Earl Warren in creative writing. Some conservatives foment empire, militarism, surveillance, and presidential hubris through their *own* juridical and judicial activism.

Such are the raw materials of UET, but there are a few more points of interest.

Unenumerated Powers Don't Exist

1. Presidents reach for "all *other* unenumerated powers"; but by a well-known canon of construction, powers *not enumerated* are not "granted" and *do not exist*. The claim *assumes* the very thing to be proven. In *Executive Privilege*, Berger writes that, "lacking an 'enumerated' power, action is illegal" and observes that "faithfully executed" implies presidential *accountability* to Congress. Further, "executive privilege" (withholding information) asserts a power *the King had already lost*. He adds that "the Framers vested many prerogatives of the Crown in Congress and denied them to the President."

Berger remarks on the "meager scope" of the presidency's projected powers: "The words 'executive power' were thus no more than a label designed to differentiate presidential from legislative functions, and to describe the powers thereafter conferred and enumerated. To derive additional authority from this descriptive label is to pervert the design of the Framers. . . ." Further: "Madison and [James] Wilson stated that the rights of 'war and peace,' enjoyed by the King, were not included in the 'executive powers.' Patently, the Framers were determined to *cut all roots of the executive power in the royal prerogative*."

Absent royal prerogative, the U.S. president would seem to be *constitutionally* impotent as far as finding and beginning his own wars goes. Practical politics made the office what it is today. In *An Inquiry into the Principles and Policy of the Government of the United States* (1814), John Taylor of Caroline, a serious strict constructionist, char-

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acterized the presidency as driving us toward "force and fraud" and "*monarchy*, *revolution*, and *an iron government*." Election was an insufficient guard; for this reason the states put their executives under severe restrictions.

2. Presidential lawyers dig out generalities about emergencies from Hamilton's Federalist essays but little on who holds the emergency powers. Is it Congress? As an executive officer under George Washington, Hamilton "discovered" what prerogative powers he could, and presidentialists get more mileage from *this* Hamilton. Given *two* Hamiltons, his arguments are somewhat suspect. (On prerogative powers in the Constitution, present or *absent*, see Forrest McDonald's *Novus Ordo Seclorum: The Intellectual Origins of the Constitution*.)

Precedent Yields No Right

3. UE theorists dwell on text, practice, and precedent. But whether successful usurpations—some large, some microscopic—amend the Constitution is not proven. Presidents have gotten away with things. As Berger points out, presidential stonewalling, which Congress has resisted for two centuries, yields no "right" of executive privilege. Yet much rests on the larger implications of executive privilege where successfully asserted.

In *Construction Construed and Constitutions Vindicated* (1820), Taylor noted that the Stuarts collected precedents "because, successive encroachments terminate in conquest." Moreover: "precedents, both good and bad, ought to have weight. . . . But discrimination is as applicable to precedents, as to any other species of evidence . . . [and] no improvement in civil government has ever been made, or can be preserved, but by a subversion of precedents, until a form is discovered incapable of corruption."

4. UE theorists make much of the president's job of repelling invasions of American soil. That this seldom happens is, for them, beside the point. Two much-mooted cases—Pearl Harbor and 9/11—drew forth no repelling. In 1846 President Polk was not repelling but was instead provoking. Nor was the Confederate attack on Fort Sumter, after months of talk, sudden, unexpected, or repelled. Given time, advocates might find some repelling, and so what? If the president failed to repel, defenders would still defend. Where is the mighty *grant* of "executive power"?

Presidentialists hope to convince us that should a president ever *defend* American soil, he would be "making war," thereby proving—apparently—that he may make war anywhere, anytime, at will.

In "Emergency Powers and the Militia Acts," legal scholar Stephen I. Vladeck does not concede a presidential power of repelling. Instead, such actions have rested on the Militia Acts of 1792, 1795, and 1807, and their successors, that is, *on delegation by Congress*. This greatly reduces what presidents can reasonably obtain from repelling. Indeed, they just break even with *the states*, which may "engage in war" when actually invaded.

> John Taylor of Caroline, a serious strict constructionist, characterized the presidency as driving us toward "force and fraud" and "monarchy, revolution, and an iron government."

5. For UE theory, "separation of powers" works overtime, albeit rather cynically. Berger writes: "the separation of powers does not create or grant power; it only protects powers *conferred* by the Constitution. . . . [T]o argue from the bare fact of a tripartite system of government, without preliminary inquiry into the scope of each of the three powers, is like invoking the magic of numerology."

In any case, classic separation took "checks and balances" rather seriously. But if the president has his own *sovereign sphere*, how is he *checked*—or *balanced*?

This brings us to John Taylor's attack on "spherical sovereignty" in *Construction Construed*. (All emphasis has been added.) In *McCulloch v. Maryland* (1819), Chief Justice John Marshall sustained the supremacy of Congress in its sphere of action. Taylor agreed that " 'sphere' conveys an idea of something limited," but wondered "how this word . . . can be converted into a substantive uncircumscribed, by the help of the adjective 'sovereign.' " He continues: "If the sovereignty of the spheres means any sovereignty at all, it supersedes the sovereignty of the people. . . ."

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Now Taylor is not objecting to spheres, but to *sovereignty* anywhere, since American principles demand actual delegation by real principals to real (and mere) agents. *No one* has "inherent" powers.

Taylor continues: "There is no phrase in the constitution which even insinuates, that the actual divisions of power should be altered or impaired by incidental or implied powers." Further: "Individual spheres or departments are easily persuaded, like Kings, that a subordination to themselves would be better for a nation, than the occasional collisions produced by a division and limitation of power." And here was the danger: "A jurisdiction, limited by its own will, is an unlimited jurisdiction."

Taylor thought "occasional collisions" better than sovereign institutions. Rather than making Congress, executive, or court supreme in some realm, the Constitution created "co-ordinate political departments, intended as *checks upon each other*, only invested with defined and limited powers, and subjected to the sovereignty . . . *of the people*. . . ."

The Court's new-fangled "spherical sovereignty" overthrew the division of powers: "A supreme power able to abolish collisions, is also able to abolish checks, and there can be no checks without collisions." In America we "have preferred checks and collisions, to a *dictatorship of one department*. . . ." Under "the concurrent power of taxation," Congress and the states "may each pass a law, both of which may be constitutional, and yet these laws may clash with, or impede each other. . . . For this clashing the constitution makes no provision."

According to Taylor, the Court was unearthing prerogative powers for Congress, including one to "remove all obstacles to its action." Marshall sought "to unite an extension of power with an apparent adherence to the words of the constitution." Under this dodge, "it was necessary to hook every implied, to some delegated power. . . ." This is *still* the practice of a continental state that micromanages the life-world under color of regulating commerce and passes worldwide military empire off as "defense."

On Taylor's reading, no branch derives sovereign powers from idealized separateness. Powers, where they exist, were *delegated* by living Americans, not by some cloud-borne eighteenth-century paragraphs "mediating" sovereignty to federal departments.

6. UET's "flexible system for going to war" (Yoo's words) seems better fitted for finding and having wars than for actual defense of American soil. Here, where sovereignty and war powers conjure and conspire, UE theorists build on Marshall's gutting of enumerated powers and Sutherland's "inherent" prerogatives; but Taylor whipped them before they were born, even on war powers:

> . . . [T]he case of war is specially provided for by the federal constitution, because the federal government, as having no sovereignty, could not other wise have declared it. . . . As the powers of making war and peace were necessary, it became necessary also to provide for them, not *as emanations* from the principle of a sovereignty in governments, but *as delegated powers*. . . . No powers in relation to war are derived from . . . sovereignty in governments under our system; and none can be justly inferred from the conclusions of the writers upon the laws of nations. . . ." [Emphasis supplied.]

Powers, where they exist, were delegated by living Americans, not by some cloud-borne eighteenth-century paragraphs "mediating" sovereignty to federal departments.

7. Presidential "signing statements," grounded in UET, proclaim a departmental "reading" of what the president is signing into "law." Unwilling to veto, President Bush says he will enforce the law (or not) as he sees fit. The attempt came before the name. In *President: The Office and Powers,* constitutional scholar Edward S. Corwin wrote of its having been undertaken in 1946–1947: "For a court to vary its interpretation of an act of Congress in deference to something said by the President at the time of signing would be . . . to endow him with a legislative power not shared by Congress."

Signing statements aim at influencing gullible jurists and, ultimately, at excluding the courts from even their

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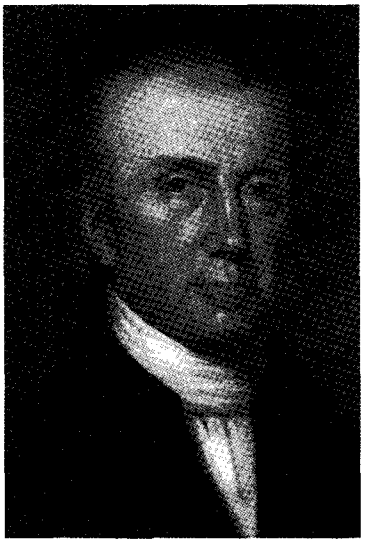
normally feckless protection of liberty during alleged wars. (On this, see Richard E. Eliel's "Freedom of Speech," *American Political Science Review*, November 1924.)

Sovereignty, Unknown Powers, Strict Construction

If we forsake "originalism," as we probably should, we need not give up strict construction. Any serious perspective must begin with contemporary comparisons of the Constitution as advertised with the Constitution as put into practice. Taylor, Spencer Roane, and others heard certain promises in the ratifying conventions and saw them broken once the promising parties were in office. Their critique rose from an unavoidable contrast. (For how quickly the Federalists' real program emerged, see *The Journal of William Maclay*, U.S. senator from Pennsylvania, 1789–91, available online and in book form.)



John Taylor of Caroline

In *Construction Construed*, Taylor went to the fundamentals. He began with "powers of sovereignty and supremacy [that] may be relished, because they tickle the mind with hopes and fears. . . ."Yet "the term 'sovereignty,' was sacrilegiously stolen from the attributes of God, and impiously assumed by Kings . . . [and] aristocracies and republicks have claimed the spoil." In any case, the "idea of investing servants with sovereignty, and that of investing ourselves with a sovereignty over other nations, were equally preposterous." (Now, of course, we do both.)

"Sovereignty" was "neither fiduciary nor capable of limitation." In America, we "eradicate[d] it by establishing governments invested with specified and limited powers," under which "the people or the states retain all the powers they have not bestowed . . . [and] ungranted rights remain also with the grantors . . . the people." This canon of constitutional interpretation, by which powers "not granted" are seen as *not granted*— hence nonexistent—failed to impress Marshall and others. With more experience of the Constitution, *we* might judge Marshall wrong.

Taylor declined to see the words "To make all laws which shall be necessary and proper for carrying into execution the foregoing powers, and all other powers vested by this Constitution in the Government of the United States"(Article I, Section 8, 18) as a charter of unknown powers; Marshall, however, saw "necessary and proper" as licensing numberless convenient and apposite means, and alongside spherical sovereignty, this was his key innovation.

Lacking certain desired powers, Congress could not simply grasp them by *calling them means* "necessary and proper" for fulfilling actually enumerated powers. Before the Revolution, Taylor noted in *Construction Construed*, Parliament contended for unlimited means of war: "The colonies replied, that it would be more absurd to limit powers, and yet concede unlimited means for their execution . . . ." Marshall's repositioning of "means" undid the whole idea of enumeration. Taylor wrote: "As ends may be made to beget means, so means may be made to beget ends, until the co-habitation shall rear a progeny of unconstitutional bastards."

Later court decisions have awarded the president the same "necessary and proper" latitude that it earlier gave Congress. The process is cumulative, but if the doctrine was unsound when aiding Congress, it remains so when fattening the executive.

Marshall undermined *American* political reasoning, said Taylor, "by inferring the powers of sovereignty from a delegated power; as the power of establishing banks, from the power of taxation . . . ." But reasoning from international law to American government was a mistake. Where foreign threats existed, "the constitution . . . disregarding . . . the laws of nations, assigns the power . . . to a department [Congress], not as being sovereign, but as being a trustee . . . [which] alone possesses a right to involve the United States in war; and no other department, *nor any individual*, has a better right to do so, than *a constable* has to bring the same calamity upon England. As the laws of nations cannot deprive congress of any power . . . so they cannot invest congress or any other department, with any power not bestowed by the constitution. . . . [Those laws] contemplate the powers of declar-

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ing war and making peace, as residing in an *executive* department; but the constitution divides them, and *does not intrust the president* with either" (emphasis supplied).

Contesting institutional sovereignty derived from international law, Taylor aimed right at UET theorists' favorite things: the war powers and their location in the system.

Can Amendment Rid Us of This Turbulent Office?

Taylor's point is, very simply, that if the government has some general "sovereignty," then it, or some branch of it, is the final judge of its actions. If the government is not sovereign, then the unknowably vast powers for war, emergencies, and so on must remain with the people, as individuals, families, or communities—a disturbing thought, even for believers in such powers. Such a theoretical placement might lead to individual civil disobedience and nullification by communities. Short of such drastic experiments, are there any constitutional cures for unitary-executive disease? Perhaps so. This brings us to our only remaining article of faith, the amending power.

Talk about unknown powers! We seem entirely free to abolish the executive in all its unitarity. Amendment, however, would require a train of disasters irrefutably stemming from that office. We have the disasters; the historical dice have been cast, but where will they land?

Meanwhile, on June 29, 2006, the Supreme Court said a few words on our subject, putting a serious dent in UE theory (*Hamdan v. Rumsfeld, Secretary of Defense, et al.*). According to the majority, the president cannot just set up his own courts with their own procedures tailor-made for producing convictions, even against "unlawful combatants." If, however, these so-called courts should conform to existing legislation (Uniform Code of Military Justice and such) becoming thereby more court-like, they might pass muster.

On larger questions, the decision moves us back, at best, toward the inconclusive and subjective language of *Youngstown Sheet & Tube Co.*, which, as noted, stated that presidents have large war powers but that Truman had overreached them. The courts, having long ago justified the deeds of Lincoln and others, can only go so far. But the decision is better than nothing, and has forced Congress, though the Military Commissions Act, to sustain the President by legislation. This has partially restored the logic of the system without, however, doing much for our liberties or for U.S. conformity with international law.

And on August 17, Judge Anna Diggs Taylor of the federal district court in southern Michigan struck another blow against UET. In *ACLU v. NSA*, she found the Bush administration's presidentially initiated NSA surveillance program illegal. The ruling denies that "inherent" presidential powers exist outside the constitution.

This is good, but we shall be waiting to see how the administration gets around it.

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Book Reviews

Three New Deals: Reflections on Roosevelt's America, Mussolini's Italy, and Hitler's Germany, 1933–1939

by Wolfgang Schivelbusch
Metropolitan Books • 2006 • 242 pages • $26.00

Reviewed by Richard M. Ebeling

During World War II the United States took on the role of the "Arsenal of Democracy," supplying its allies the wherewithal to battle Nazi Germany and Imperial Japan, as well as assuming global leadership in opposing those aggressive fascist regimes that threatened world peace. It is often forgotten, however, that in the 1930s many American and European commentators focused on the many similarities between Franklin Roosevelt's New Deal and the planned economies in fascist Italy and Nazi Germany.

Historian Wolfgang Schivelbusch takes a fresh look at these similarities in *Three New Deals*. He is quick to point out that he is not saying that FDR's New Deal was the same as the Nazi regime. Hitler rapidly established an absolute dictatorship that suppressed all political opposition. In America civil liberties and freedom of the press were never abridged by the Roosevelt administration, however much political and economic power was increasingly concentrated in Washington during the 1930s.

But nonetheless the methods of controlling the economy and influencing public opinion were closely parallel, as Schivelbusch shows. World War I had ushered in a new politicization of society and captured the spirit of many intellectuals and policy advocates in the 1920s and 1930s. Government architecture in Soviet Russia, Nazi Germany, fascist Italy, and FDR's America were all bigger than life, creating an imagery of power and awe transcending the mundane efforts and achievements of private individuals.

What Schivelbusch brings out is the change in the role and conception of political leadership. Gone was the notion that those in political office were executors of constitutionally limited responsibilities. Now the "leader" spoke and led outside the ordinary restraints of the political process. Both Hitler and Roosevelt appealed to "the people" directly, with the claim that unusual circumstances required extraordinary authority. With his fireside chats FDR took advantage of a popular new technology, radio, to create the impression that he was addressing every American's hopes and fears; the President thus became a member of every family.

In Germany radios were far less widely used. So Hitler took advantage of that other means of mass communication—giant rallies and ceremonies at which thousands could directly see and hear their Fuehrer. But even in the United States rallies and parades were used to arouse support for the New Deal recovery programs, especially the National Recovery Administration, which tried to impose the same type of fascist planning on business that Mussolini and soon Hitler established in their countries.

Grand government projects were all part of the projection of state power and authority. In Italy Mussolini cleared the Pontine Marshes outside Rome and designed model communities for resettlement of the unemployed. In Germany Hitler oversaw the construction of the autobahn system even though the number of privately owned cars was a fraction of that in the United States. In America the power of government was symbolized by the Tennessee Valley Authority, through which Washington changed the course of rivers, built massive dams, and electrified an entire region of the country. Of course in every one of those projects, the people whose lives were disrupted or uprooted counted for little compared to the task of remaking society according to the central plans of the "leaders."

Military power was an essential imagery in the rhetoric. Hitler glorified uniformed legions in torch-lit parades. Roosevelt emphasized military imagery in his speeches, such as his 1933 inaugural address, in which he spoke of the Depression as if it were a foreign foe. If Americans did not voluntarily comply with his proposed recovery programs, he would not hesitate to use the full coercive powers of the state to win the "war"

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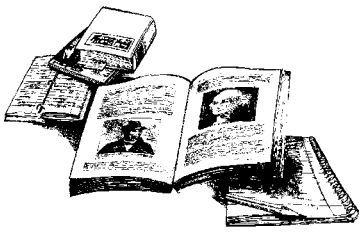
against unemployment. He spoke of the Blue Eagle, the symbol of the NRA, as a badge that all patriotic businesses should proudly display to prove they were doing their part and to distinguish them from "enemies" of recovery who refused to go along with the government's plans.

American and European commentators in the 1930s also pointed out Hitler's and Roosevelt's centralization of power. Dictatorship was never imposed in the United States in the same way it was in Nazi Germany, but thoughtful writers wondered if such centralization did not run the risk of undermining the constitutional separation of powers. Unchecked power could easily extinguish freedom in the United States.

Finally, Schivelbusch reminds his readers of a book by John T. Flynn, *As We Go Marching*, that was published in 1944. Flynn had been a long-time critic of the New Deal. In the book he pointed out the many similarities among the three fascisms. Italian and German fascism were the "bad" kind. But the American brand was dangerously seen as the "good fascism," Flynn warned. Wrapped in the stars and stripes and presented as a new dawn of American economic vitality and global leadership, complete with unrestrained presidential power, the American brand of fascism threatened to destroy all that the Founding Fathers had built for a country of liberty.

Regulation and planning at home, political and military adventures abroad, and greater power in the hands of the head of state meant a different type of America from what had existed in the past, Flynn feared. Six decades later those dangers seem in many ways even more real than in 1944. Wolfgang Schivelbusch has reminded us that the danger of concentrated political power was understood back in the 1930s. We should pay attention today.

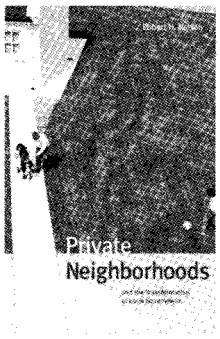
Richard Ebeling (rebeling@fee.org) is the president of FEE.



Private Neighborhoods and the Transformation of Local Government

by Robert H. Nelson
Urban Institute Press • 2005 • 494 pages • $32.50 paperback

Reviewed by Sandy Ikeda



In *Private Neighborhoods and the Transformation of Local Government*, Robert H. Nelson effectively frames the discussion of what minimal government might look like in terms of personal choices based on local knowledge. He looks at the issue from the ground up rather than the top down.

Nelson argues that while all levels of American government have been expanding since World War II, people have responded with a spontaneous and massive movement toward local governance. This has taken two main forms.

The first is what he calls the "privatization of municipal zoning," in which city zoning boards grant changes or exemptions to developers in exchange for cash payments or infrastructure improvements. "Zoning has steadily evolved in practice toward a collective private property right. Many municipalities now make zoning a saleable item by imposing large fees for approving zoning changes," Nelson writes.

In one sense, of course, this is simply developers openly buying back property rights that government had previously taken from the free market, and "privatization" may be the wrong word for it. For Nelson, however, it is superior to rigid land-use controls that would prevent investors from using property in the most productive way. Following Ronald Coase, Nelson evidently believes it is more important that a tradable property right exists than who owns it initially.

The second spontaneous force toward local governance has been the expansion of private neighborhood associations and the like. According to the author, "By 2004, 18 percent—about 52 million Americans—lived in housing within a homeowner's association, a condominium, or a cooperative, and very often these private communities were of neighborhood size."

Nelson views both as positive developments on the

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whole. They are, he argues, a manifestation of a growing disenchantment with the "scientific management" of the Progressive Era. He thinks the devolution of governance below the municipal level to the neighborhood should be supported through statutory and state constitutional changes.

Although about one-third of all new housing since 1970 has been built within some form of neighborhood association, the majority of older neighborhoods fall outside this trend. Establishing neighborhood associations in these areas is difficult because the requirement for a homeowner to join is typically written into the deed, and this would be extremely costly to do for every home in an older neighborhood.

Nelson proposes a six-step solution that involves (1) a petition by property owners in a neighborhood to form an association, (2) state review of the proposal, (3) negotiations between the city and the neighborhood, (4) a neighborhood vote on the proposal, (5) a required supermajority, perhaps 70 percent, for passage, and (6) a transfer from the municipality of legal responsibility for regulating land use in the neighborhood to the unit owners of the association.

The sticky point from a classical-liberal perspective, of course, is what happens to the rights of the minority of residents who might oppose the proposal. For Nelson this would be a cost of creating a more liberal society in the long run. But many will object to his advocacy of political means to transform established neighborhoods into private ones.

Others may find overstated his claim that "the rise of private neighborhood associations in the United States has probably resulted in a greater reduction in individual freedom of action than any other social development of the second half of the 20th century," calling it "private socialism." Nelson's point, however, is that these trends have tended to constrain the daily choices of Americans even as they have decentralized governance. On the other hand, he correctly points out, invoking F. A. Hayek, that local governance is apt to be more responsive to local concerns than traditional centralized municipal government.

Nelson's vision extends far beyond a nation in which all residences are part of a homeowners association. First, private governance will not be limited to residential communities, but will extend to business and community-improvement districts as well. Second, he sees these private neighborhoods as mostly self-financing—with the city and county rebating taxes for those services funded and provided by the associations themselves—and empowered to decide the mix of land uses that accord with their own residents' demands.

There is some concern that private neighborhoods would permit objectionable discriminatory practices. Nelson responds that this not only reveals a tendency to regard ordinary people as bigots, but more important, it also ignores the role of "exit," or competition among communities, in constraining the powers of local authorities. "Other things equal, citizens will prefer more and smaller local governments to fewer and larger governments," he says. Widespread and effective local governance will, on the whole, offer a wider range of choice to individuals, as the lower cost of moving from one private neighborhood to another increases any inhabitant's threat of competitive exit. Nelson further argues that imposing a uniform ideology or moral code is no solution, except for the broadest strictures against aggression and fraud, because this would make the attempt to form individualized neighborhood governance pointless.

Nelson seems to be proposing a kind of minimalist polyarchy—the Greek *polis* in modern form. With the exception of certain macro-services such as regional defense, governance would consist mostly of choices made by the inhabitants of one's own neighborhood. Governance and centralized government are not the same thing.

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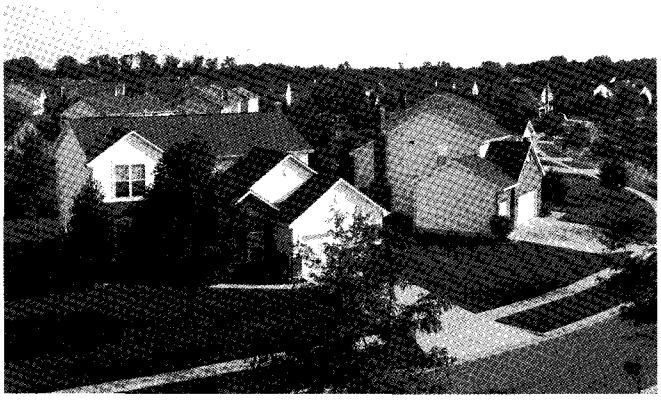

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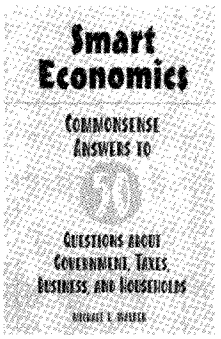
Smart Economics: Commonsense Answers to 50 Questions about Government, Taxes, Business, and Households

by Michael L. Walden
Praeger • 2005 • 202 pages • $34.95

Reviewed by George C. Leef



Thanks to a steady diet of misinformation from teachers, politicians, and the media, most Americans believe a great many false ideas regarding the economy. Many believe, for example, that a "single-payer" health-care system would improve care and lower costs, and that the collectivist pitch line "the rich are getting richer while the poor are getting poorer" is true. Ideas like that incline people toward the acceptance of policies that increase the size and power of the state—to the detriment of us all.

In an effort to counteract economic misunderstanding, North Carolina State University economics professor Michael Walden has written *Smart Economics: Commonsense Answers to 50 Questions About Government, Taxes, Business, and Households.* It consists of 50 short essays, usually about three pages in length, each of which takes on a common misconception rooted in people's lack of economic sophistication. The virtue of the book is that it so easily and clearly identifies the errors in reasoning that lead so many Americans astray. If everyone read and understood *Smart Economics*, politicians and interest groups would have a much more difficult time hoodwinking the country into supporting statist, interventionist measures.

Walden is not trying to promote any political agenda of his own. In fact, his chief motive in writing the book is to depoliticize economic thinking. He rues the fact that partisans on the left and right use deceptive economic arguments to advance their preferences for action by the state. Walden just wants Americans to be able to see through fallacious economic arguments.

Here's a sampling from the book.

In one chapter Walden asks whether budget deficits cause interest rates to rise. Politicians and others who want an excuse to raise taxes often point to the massive budget deficits of the federal government and say, "If we don't do something about that, government borrowing to cover the deficit will drive up interest rates, and that would be bad." (Hardly ever do we hear the logical conclusion that the government should spend less!) Walden demolishes the supposed connection between budget deficits and interest rates with empirical evidence (sometimes rates go down when deficits are large and sometimes they go up when deficits are small) and with economic reasoning (federal borrowing is just one of many factors that affect interest rates).

In another chapter the author tackles the notion that war is an economic stimulus. Lots of Americans believe, for example, that it was the huge federal spending of World War II that finally brought the country out of the Great Depression. Walden explains the crucial concept of opportunity cost to shatter that myth. "Spending $1 million on artillery shells to blow up targets leaves nothing in return, whereas spending that same million on new factory technology can pay dividends to the business for years to come."

Or consider this recent governmental fad—laws against "price gouging." Most Americans think that such laws are good, allowing politicians to revel in the publicity that they have done something to "protect" people hurt by natural disasters from the added injury of greedy businesses raising their prices. Such laws, however, are actually damaging. "Higher prices," Walden writes, "are like a bright light signaling to manufacturers and dealers that more money can be made by selling their wares in the disaster-ravaged region." Exactly so.

What about profits? Many people are inclined to think that prices would be lower if only businesses didn't try to make a profit. Their misunderstanding helps anti-market politicians when they propose "windfall profits taxes" and price controls. Walden does an excellent job in showing that the search to make the most profit in a free market actually keeps costs down and quality up.

Other topics covered in *Smart Economics* include corporate taxation, free trade and the imaginary harm of having a "trade deficit," whether the United States should strive for energy self-sufficiency, the notion that American manufacturing is dying, the supposed inability of American workers to compete with low-wage

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workers in developing countries, the belief that under capitalism "the rich get richer and the poor get poorer," and the myth that government intervention can lower health-care costs for people.

Only rarely does Walden fail to cut right to the heart of an issue, but I'll cite one instance. In discussing the idea that more spending on public schools will improve student performance, he writes that it can "as long as that spending is done in the classroom." Given the socialist structure of public education, I don't think there is reason to believe that more spending anywhere necessarily leads to improvement. By failing to discuss the inherent flaw in government schooling, Walden missed the jugular.

Nevertheless, this book is a splendid effort. Get a copy for friends who need to be gently steered away from their economic myths.

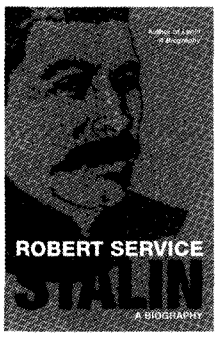
George Leef (georgeleef@aol.com) is book review editor of The Freeman.

Stalin: A Biography

by Robert Service

Harvard University Press • 2005 • 760 pages • $29.95 hardcover; $19.95 paperback

Reviewed by Yuri Maltsev



Robert Service is a well-known specialist in twentieth-century Russian history. His new biography of Stalin is an attempt to provide the reader with a comprehensive view of the man who influenced modern history more than almost anyone else. He still affects our lives today. His followers are numerous and fanatical; his shadow is behind the terrorist regimes of North Korea, Cuba, and Iran; he is still revered in communist China and Vietnam; and he is the role model for tyrants like Robert Mugabe, Hugo Chávez, Kim Jong Il, and Aleksandr Lukashenko. Together with Lenin, Stalin built the infamous Gulag in which tens of millions of people of almost all nationalities, religions, and social standing were tortured and murdered. Stalin initiated the spread of state totalitarianism.

Service provides us with a fuller assessment of Stalin not only as a serial political killer and a bureaucratic perfectionist, but also as a revolutionary, a well-read writer and editor, and as a family man and poet. He challenges the conventional image of Stalin as an uneducated Georgian criminal and ruthless administrator transformed into a pathological killer. This biography reveals the complex and fascinating story behind the monster who dominated the twentieth century. Drawing on unexplored archives and personal testimonies gathered from across Russia and Georgia, this is the best biography of the Soviet dictator to date.

Stalin created his own personality cult and was presented to the masses in the Soviet Union and abroad as a colossal father figure. The intensity of this cult can be compared only with Islamic fundamentalism. This development began in the 1930s, when Stalin consciously established himself in the line of great symbolic figures like Ivan the Terrible, whose image in the minds of the common people was that of a harsh but just protector.

This adulation for the man at the helm was so unconditional that even citizens persecuted and imprisoned by Stalin's power apparatus mourned in their prison cells when they heard of his death in March 1953. The news of Stalin's death came as a tremendous shock to the people of Russia. For almost 30 years he had been portrayed (and was widely seen) as the man on whom all their lives, as well as the whole world, depended. Accordingly, on his death the masses felt orphaned, bereft of all guidance, and lapsed into the most profound despondency.

The number of Soviet citizens thronging to attend the funeral ceremony exceeded all expectations, and in Moscow the KGB and militia were overtaxed. As a result, "thousands of individuals were trampled and badly injured, and the number of people who suffered fatal asphyxiation (which was withheld from newspapers) went into the hundreds. Even in his coffin the Leader had not lost his capacity to deal out death at random to his subjects," Service writes.

In examining the multidimensional legacy of Stalin, Service helps explain why later would-be reformers—such as Khrushchev and Gorbachev—found the Stalinist legacy almost impossible to dislodge. The people had

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become so habituated to servility and dependence on the state that even timid reforms were regarded by many with horror.

Russia is still laboring under the tragic effects of Stalin's regime. In many regions the rural population lives under conditions that have seen no change since the time of the tsars. Furthermore, the gigantic enterprises of heavy industry built by Stalin and his successors are disintegrating all over the former Soviet Empire, leaving environmental disasters and hundreds of thousands of disgruntled and unemployed workers. Coercive collectivization and industrialization cost the country millions of lives. Despite all that, the adulation for Stalin in Russia (less common in other parts of the former USSR) is intriguing. Many Russians (65 percent according to a recent public-opinion poll) still regard him as one of the greatest personalities their country has ever produced.

Today, over 50 years after his death, committed Stalinists are a vocal group in Russia. Russian President Putin is known to be a closet Stalinist himself, raising toasts at Kremlin receptions to the memory of the Master. His own popularity is based on the cult of a strong man leading the country. The idea that society can only be managed by an autocrat with an iron fist still dominates the Russian mind, and Service's book helps to explain how that sad state of affairs was brought about.

Stalin: A Biography is a serious contribution to our understanding of this most evil historical figure and should serve as a warning against rising autocratic regimes in Russia and elsewhere.

Yuri Maltsev (maltsev.yuri@gmail.com) is professor of economics at Carthage College, Kenosha, Wisconsin.

Coming in the March issue of *The Freeman*

Raising the Minimum Wage Will Do No Harm? It Just Ain't So!

by Richard B. McKenzie

The Economics of Property Rights

by Andrew P. Morriss

Europe: Still a Laggard Economy

by Norman Barry

Punishing the Innocent: The Sarbanes-Oxley Act

by Barbara Hunter

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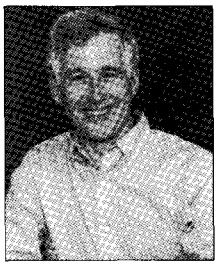
Big Government—Big Risk



BY DAVID R. HENDERSON

In his *Freeman* column last June, "The End Run to Freedom," economist Russell Roberts makes the following argument: As people get wealthier, they demand more security. Their demand for security leads many people to favor the welfare state or the nanny state. The welfare state refers to a government that subsidizes people who bear losses; the nanny state refers to a government that regulates people's lives to prevent them from taking certain risks that could lead to losses. The role of free-market advocates is to point out that much of the security that people demand can be provided by the free market. That is Russell Roberts's argument, and I agree with it. As far as it goes.

But Roberts's argument implicitly assumes that government provides security. That assumption flies in the face of much evidence on the welfare/nanny state. It ignores the government's sometimes-lethal iron fist that is only modestly hidden beneath its velvet glove. Government's tragic track record shows that regulations and spending programs often make people less secure. And even when they provide security, they often do so by trading one risk for another, sometimes bigger risk. Consider three areas where this happens: drugs, education, and jobs.

Government's tragic track record shows that regulations and spending programs often make people less secure.

Since 1962 the Food and Drug Administration (FDA) has required that any new drug be tested not just for safety but also for efficacy. Economists have estimated that the efficacy requirement has added many years to the time between a drug's discovery and its sale. Let's grant that the requirement for proof of safety reduces risk. But the regulation that requires proof of efficacy does little or nothing to decrease risk and necessarily increases risk, sometimes lethally. Imagine you have a terminal disease and, without a drug that is currently being tested for efficacy, you will die in six months. Unfortunately, the drug won't be on the market until after that. Imagine there is a 30-percent probability that it would extend your life. Has the government reduced your risk by forcibly preventing you from taking it? This example is not hypothetical. Economist Daniel Klein estimates that withholding new effective drugs causes at least 50,000 premature deaths a year. (See "Economists Against the FDA," *The Freeman*, September 2000.)

And think of other drugs that government regulators try to prevent you from taking—drugs like marijuana, cocaine, LSD, and heroin. Here the issue is a trade-off of risks. One could argue that if the government makes the penalties harsh enough, you will decide not to take these drugs and will therefore avoid the associated risks. But stopping the analysis there is to engage in single-entry bookkeeping. We need to examine the other side of the ledger: the risks that government creates. For those who decide to use the drugs anyway, their risk is much greater—and the higher risk is due to government regulation. They face two new risks they wouldn't face if the drugs were legal. The first is the risk of getting an impure drug. When drugs are illegal, providers do not have the same incentive or ability to provide high quality and establish a good reputation that they would have if the drugs were legal. Many people who die from illegal drugs do so because they don't know the potency of the drugs or what they are spiked with.

The second is the risk of going to jail. One of the few effective anti-drug ads run by the federal government

David Henderson (drhend@mbay.net) is a research fellow with the Hoover Institution and an associate professor of economics at the Naval Postgraduate School in Monterey, California. He is the coauthor with Charles Hooper of Making Great Decisions in Business and Life.

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was the one that showed a drug user running from the cops. But notice that this risk is entirely government-created: if drugs were legal, there would be no risk of going to prison just for using them. And the risk of going to prison is not one of those little risks. As the drug warriors correctly point out, going to prison could wreck your life.

One might argue—and many do—that we should not be sympathetic to those who take illegal drugs and go to jail. To this I have two answers. First, those who make the argument cannot also argue for drug laws on the basis of saving people from harm because they have revealed that they don't care about those people being harmed. Second, when I ask even strongly anti-drug audiences what they would do if they found illegal drugs in their teenager's room, they never say they would report their child to the police. So they do seem capable of being sympathetic to at least some people who risk going to prison.

My second example of where government creates risk is the schools. Most schools in the United States are government-run, and parents are forced by law to enroll their students at these schools, at private schools, or in home-schools. Government schooling is not cheap: it now costs about $7,200 per student, which is about $2,500 more than the average tuition at private schools. But because government gives it away "free," only those who value private schooling very highly will choose it for their children. If private school tuition is $4,700, for example, you won't buy it unless it's worth $4,700 more than the value of what the government school provides.

What does this have to do with risk? When you drop your child off at the government school, you have little control over what happens to him or her. Within broad limits the government can do a lot to your kid: teach him things you'd rather he not know, such as how to put a condom on a banana; teach him things that are not true, such as the idea that the industrialists of the late nineteenth century were "robber barons"; and, in thousands of little ways, deaden your child's inherent love of learning. I'd call that a pretty big risk. Of course, all this can and does happen in private schools. But with lots of private-school choices, which you would have if the government exited the business and cut taxes to reflect its lower spending, the risk would be much less.

Harm from Forced Higher Wages

Finally, consider jobs. Government regulations give unions the power to force people to join or to at least have the union represent them in wage bargaining. Unions use that power to bargain for wages higher than they could have otherwise. At those higher wages new workers are less likely to find jobs and must settle for lower-paying jobs in nonunion sectors of the economy. When there's a downturn in the economy, employers, facing unions that want to preserve higher-paying jobs for their more senior members, lay off the more-junior workers. Absent the unions' legal monopoly, the employers and workers could have bargained for lower wages that preserved more jobs. So the loss in freedom due to government-granted union privileges goes hand in hand with a loss in security for younger, less-experienced workers.

Big government is a big lottery, and as in all lotteries, your expected winnings (which equal the probability of winning multiplied by the prize) are substantially less than the price of the ticket. But there is a fundamental difference between the big-government lottery and the typical game of chance. In the latter, the participants choose to play; in the big-government lottery everyone is forced to play.

Benjamin Franklin once said that those who are willing to trade liberty for security deserve neither. They'll also get neither. If my major goal were security, I would want, even more than I do, freedom from government.

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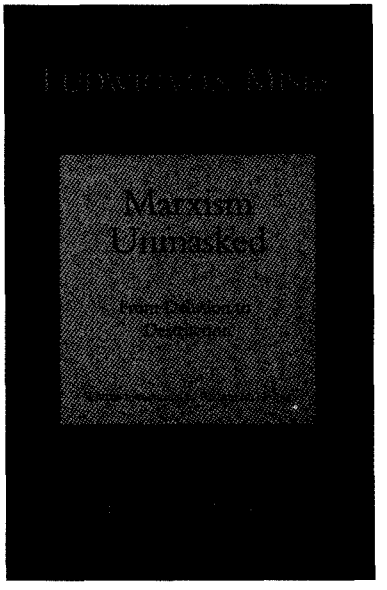
Marxism Unmasked: From Delusion to Destruction

Edited and with an introduction by Richard M. Ebeling



In the summer of 1952 Ludwig von Mises delivered a series of lectures at a seminar in San Francisco sponsored by *The Freeman* magazine. Bettina Bien Greaves, a member of FEE's staff at the time, took down every word of each lecture in shorthand and faithfully transcribed them for eventual publication.

Marxism Unmasked: From Delusion to Destruction uniquely captures Mises as teacher. Unlike many of his longer, more formal writings, these lectures are peppered with numerous historical asides and common-sense examples that convey the ease and spirit of the spoken word.

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